A123 SYSTEMS, INC.
Form 10-Q
November 09, 2011

Use these links to rapidly review the document
Table of Contents

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

ý **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2011

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to
Commission file number: 001-34463

A123 Systems, Inc.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**04-3583876** (I.R.S. Employer Identification No.)
A123 Systems, Inc. **200 West Street** **Waltham, Massachusetts** (Address of principal executive offices)	**02451** (Zip Code)

617-778-5700
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ý	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No ý

As of November 4, 2011, there were 126,078,992 shares of the registrant's Common Stock, par value $.001 per share, outstanding.

Table of Contents

A123 Systems, Inc.
Quarterly Report on Form 10-Q
For the Quarterly Period Ended September 30, 2011

INDEX

EX-10.34 Credit Agreement dated September 30, 2011, among the Registrant, the Several Lenders from time to time parties thereto, and Silicon Valley Bank
EX-31.1 CEO Certification pursuant to Section 302 of the Sarbanes-Oxley Act
EX-31.2 CFO Certification pursuant to Section 302 of the Sarbanes-Oxley Act
EX-32.1 CEO Certification pursuant to Section 906 of the Sarbanes-Oxley Act
EX-32.2 CFO Certification pursuant to Section 906 of the Sarbanes-Oxley Act
EX-101.INS XBRL Instance Document
EX-101.SCH XBRL Taxonomy Extension Schema Document
EX-101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
EX-101.LAB XBRL Taxonomy Extension Label Linkbase Document
EX-101.PRE XBRL Taxonomy Extension Presentation Linkbase Document
EX-101.DEF XTRL Taxonomy Extension Definition

Table of Contents

Part I. Financial Information

Item 1. Financial Statements

A123 Systems, Inc.

Condensed Consolidated Balance Sheets

(in thousands, except share and per share data)

	December 31, 2010	September 30, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$ 216,841	$ 225,818
Restricted cash and cash equivalents	9,367	725
Accounts receivable, net	28,106	59,443
Inventory	47,765	99,493
Deferred cost	1,022	13,444
Prepaid expenses and other current assets	8,006	9,164
Total current assets	311,107	408,087
Property, plant and equipment, net	143,998	161,113
Goodwill	9,581	9,581
Intangible assets, net	413	252
Long-term grant receivable	75,790	99,459
Deposits and other assets	11,768	8,898
Restricted cash and cash equivalents, net of current portion	1,993	99
Investments	21,508	23,533
Total assets	$ 576,158	$ 711,022
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Revolving credit lines	$ 8,000	$ 38,094
Current portion of long-term debt	5,379	3,421
Current portion of capital lease obligations	1,571	1,792
Accounts payable	43,523	65,879
Accrued expenses	48,179	39,634
Other current liabilities	1,322	1,316
Deferred revenue	11,109	7,990
Deferred rent	132	185
Total current liabilities	119,215	158,311
Long-term debt, net of current portion	4,603	142,500
Capital lease obligations, net of current portion	18,655	17,740
Deferred revenue, net of current portion	29,836	28,809
Deferred rent, net of current portion	1,452	1,248
Other long-term liabilities	3,865	9,752
Total liabilities	177,626	358,360
Commitments and contingencies (Note 6)		
Stockholders' equity:		
Preferred stock, $0.001 par value 5,000,000 shares authorized; 0 shares issued and outstanding at December 31, 2010 and September 30, 2011		
Common stock, $0.001 par value 250,000,000 shares authorized; 105,194,073 and 126,073,992 shares issued and outstanding at December 31, 2010 and September 30, 2011, respectively	105	126

Additional paid-in capital	790,256	917,835
Accumulated deficit	(391,228)	(563,981)
Accumulated other comprehensive loss	(935)	(1,318)
Total A123 Systems, Inc. stockholders' equity	398,198	352,662
Noncontrolling interest	334	
Total stockholders' equity	398,532	352,662
Total liabilities and stockholders' equity	$ 576,158	$ 711,022

See notes to condensed consolidated financial statements.

1

Table of Contents

A123 Systems, Inc.

Condensed Consolidated Statements of Operations

(in thousands, except per share data)

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2011
Revenue:				
Product	$ 18,965	$ 59,603	$ 54,297	$ 104,625
Services	7,253	4,716	18,997	14,144
Total revenue	26,218	64,319	73,294	118,769
Cost of revenue:				
Product	23,755	78,014	65,086	157,928
Services	5,538	5,878	16,273	13,422
Total cost of revenue	29,293	83,892	81,359	171,350
Gross loss	(3,075)	(19,573)	(8,065)	(52,581)
Operating expenses:				
Research, development and engineering	16,019	19,181	43,967	56,974
Sales and marketing	3,506	4,515	9,672	13,667
General and administrative	9,860	16,289	26,904	34,799
Production start-up	11,751	1,097	17,168	9,215
Total operating expenses	41,136	41,082	97,711	114,655
Operating loss	(44,211)	(60,655)	(105,776)	(167,236)
Other income (expense):				
Interest expense, net	(199)	(2,227)	(789)	(4,973)
Gain (loss) on foreign exchange	713	(98)	(268)	(19)
Other (expense) income, net	87	(143)	87	530
Total other expense, net	601	(2,468)	(970)	(4,462)
Loss from operations, before tax	(43,610)	(63,123)	(106,746)	(171,698)
Provision for income taxes	125	594	378	1,082
Net loss	(43,735)	(63,717)	(107,124)	(172,780)
Less: Net loss attributable to the noncontrolling interest	79		225	27
Net loss attributable to A123 Systems, Inc.	$ (43,656)	$ (63,717)	$ (106,899)	$ (172,753)
Net loss per share attributable to A123 Systems, Inc. basic and diluted:	$ (0.42)	$ (0.51)	$ (1.03)	$ (1.45)

Weighted average number of common shares outstanding basic and diluted	104,743	126,049	104,135	118,767

See notes to condensed consolidated financial statements.

Table of Contents

A123 Systems, Inc.

Condensed Consolidated Statements of Stockholders' Equity

(in thousands, except per share data)

	Common Stock, $0.001 Par Value Shares	Common Stock, $0.001 Par Value Amount	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Stockholders' Equity	Noncontrolling Interest	Comprehensive Loss
BALANCE January 1, 2010	102,606	$ 103	$ 767,694	$ (238,668)	$ (909)	$ 528,220	$ 110	
Stock-based compensation			8,382			8,382		
Issuance of common stock and exercise of stock options	2,250	2	9,563			9,565		
Comprehensive loss:								
Net loss				(106,899)		(106,899)	(225)	$ (107,124)
Foreign currency translation adjustment					(12)	(12)		(12)
Total comprehensive loss								$ (107,136)
BALANCE September 30, 2010	104,856	$ 105	$ 785,639	$ (345,567)	$ (921)	$ 439,256	$ (115)	
BALANCE January 1, 2011	105,194	$ 105	$ 790,256	$ (391,228)	$ (935)	$ 398,198	$ 334	
Stock-based compensation			10,411			10,411		
Exercise of stock options	638	1	2,001			2,002		
Vesting of restricted stock units	58							
Issuance of common stock	20,184	20	115,167			115,187		
Purchase of subsidiary shares by noncontrolling interest holder								
Deconsolidation of subsidiary							(307)	
Comprehensive loss:								
Net loss				(172,753)		(172,753)	(27)	$ (172,780)
Foreign currency translation adjustment					(383)	(383)		(383)
Total comprehensive loss								$ (173,163)

BALANCE September 30, 2011	126,074	$	126	$	917,835	$	(563,981)	$	(1,318)	$	352,662	$

See notes to condensed consolidated financial statements.

Table of Contents

A123 Systems, Inc.

Condensed Consolidated Statements of Cash Flows

(in thousands)

	Nine Months Ended September 30,	
	2010	**2011**
Cash flows from operating activities:		
Net loss	$ (107,124)	(172,780)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	12,234	18,230
Noncash rent	777	(150)
Noncash foreign exchange gain on intercompany loan	(322)	
Noncash (gain) loss on equity investments	(87)	768
Impairment of long-lived and intangible assets	530	2,645
Gain on asset transfer and subsequent deconsolidation of variable interest entity		(1,255)
Loss on disposal of property and equipment	250	28
Amortization of debt issuance costs and noncash interest expense		1,892
Stock-based compensation	8,382	10,411
Changes in current assets and liabilities, excluding the effect of deconsolidation of VIE:		
Accounts receivable	(9,996)	(33,392)
Inventory	(3,716)	(52,047)
Deferred cost	(1,338)	(12,422)
Prepaid expenses and other assets	(3,281)	(2,839)
Accounts payable	17,973	26,718
Accrued expenses	(3,111)	14,294
Deferred revenue	3,793	(2,046)
Other liabilities	(1,381)	3,967
Net cash used in operating activities	(86,417)	(197,978)
Cash flows from investing activities:		
(Increase) decrease in restricted cash	(1,649)	10,536
Purchases of and deposits on property, plant and equipment	(107,780)	(113,729)
Proceeds from government grant	49,642	32,022
Purchase of investments	(14,862)	(3,288)
Net cash used in investing activities	(74,649)	(74,459)
Cash flows from financing activities:		
Proceeds from issuance of common stock, net of offering costs		115,187
Proceeds from government grant	7,250	900
Proceeds from exercise of stock options	3,067	2,002
Proceeds from revolving credit lines		38,094
Proceeds from issuance of debt, net of offering costs		138,824
Principal payments on revolving credit line and long term debt	(5,219)	(12,028)
Payments on capital lease obligations	(477)	(2,148)
Contributions from noncontrolling interest		600
Net cash provided by financing activities	4,621	281,431
Effect of foreign exchange rates on cash and cash equivalents	156	(17)

Net (decrease) increase in cash and cash equivalents		(156,289)		8,977
Cash and cash equivalents at beginning of period		457,122		216,841
Cash and cash equivalents at end of period	$	300,833	$	225,818
Supplemental cash flow information cash paid for interest	$	732	$	531
Noncash investing and financing activities:				
Purchase of equipment under capital leases	$	4,286	$	153
Increase in accounts payable and accrued expenses for property, plant and equipment	$	38,525	$	26,996
Deferred financing costs included in accounts payable and accrued expenses	$		$	342
Issuance of common stock for investment	$	7,495	$	
Fulfillment of government grants with advance proceeds	$		$	1,046

See notes to condensed consolidated financial statements.

A123 Systems, Inc.

Notes to Condensed Consolidated Financial Statements

1. Nature of the Business, Basis of Presentation, and Significant Accounting Policies

A123 Systems, Inc. (the "Company") was incorporated in Delaware on October 19, 2001 and has its corporate offices in Waltham, Massachusetts. The Company designs, develops, manufactures and sells advanced rechargeable lithium-ion batteries and battery systems and provides research and development services to government agencies and commercial customers.

Management Plan Note In April 2011, the Company raised a total of $253.9 million of net proceeds from the issuance of $143.8 million in principal of convertible unsecured subordinated notes (the "Convertible Notes") and the issuance of 20.2 million shares of the Company's common stock at $6.00 per share to fund the Company's growth and expansion plans, including funding anticipated future losses, purchase commitments and capital expenditures. Net proceeds for the Convertible Notes and common stock offerings, after deducting issuance costs, were $138.8 million and $115.2 million, respectively. See Note 7 for additional details of the Convertible Notes. In September 2011, the Company entered into a credit agreement providing the Company with a revolving loan facility in the amount of $40.0 million. See Note 6 for additional details on the revolving line of credit. The Company has invested the unused portion of the net proceeds from the common stock and Convertible Notes offerings in interest-bearing investment-grade securities.

To fund our growth over the next 12 months, including anticipated future losses, purchase commitments, and capital expenditures, the Company is taking actions to reduce the cash used in operating and investing activities including plans to improve our gross margins, reduce its operating expenses, and increase inventory turns. However, the Company may also choose to raise additional capital to fund cash requirements through expansion of the existing line of credit and/or additional strategic partnerships. As noted above the Company has been successful in raising funds and most recently, on November 7, 2011, the Company announced a series of agreements with IHI Corporation that will provide, among other things, $25.0 million through the sale of common stock and a one-time, non-refundable license fee of $7.5 million for a technology license agreement. The Company has also been in discussion with other potential strategic partners that could provide additional capital as well as improved access to different markets in which to sell our products. Although the Company is hopeful that it will be able to improve its operating efficiencies and be able to obtain additional financing through new partnerships, there is no guarantee that it will be able to achieve such expected improvements in operating performance or that it will be able to obtain such external funding.

Basis of Presentation The accompanying condensed consolidated financial statements and the related disclosures as of September 30, 2011 and for the three and nine months ended September 30, 2010 and 2011 are unaudited and have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") and the applicable rules and regulations of the Securities and Exchange Commission ("SEC") for interim financial information. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. These interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto contained in the Company's Annual Report on Form 10-K filed with the SEC on March 11, 2011. The December 31, 2010 condensed consolidated balance sheet included herein was derived from the audited financial statements as of that date, but does not include all disclosures required by GAAP for complete financial statements.

The interim condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and, in the opinion of management, reflect all adjustments of a normal recurring nature considered necessary to present fairly the Company's financial

A123 Systems, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

1. Nature of the Business, Basis of Presentation, and Significant Accounting Policies (Continued)

position as of September 30, 2011 and results of its operations for the three and nine months ended September 30, 2010 and 2011, and its cash flows for the nine months ended September 30, 2010 and 2011. The interim results for the three and nine months ended September 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011.

Principles of Consolidation The accompanying condensed consolidated financial statements include the accounts of the Company and its subsidiaries. All intercompany balances and transactions have been eliminated in consolidation. In February 2011, the Company entered into an agreement to transfer certain of its assets held by its wholly owned Korean subsidiary to its joint venture with a quasi governmental entity in the Peoples' Republic of China. For the three and nine months ended September 30, 2010 and as of December 31, 2010, the joint venture was consolidated as a variable-interest entity, but did not have a material impact on the Company's consolidated financial operations and did not represent a material portion of the Company's total consolidated assets. Subsequent to the transfer in February 2011, the Company no longer is significantly involved in the operations of the joint venture and therefore no longer consolidates the joint venture; however, the Company retains a minority ownership stake in the entity which is accounted for as a cost method investment as of September 30, 2011. The asset transfer and subsequent deconsolidation of the joint venture resulted in a $1.2 million gain recognized in other expense, net for the nine months ended September 30, 2011.

Use of Estimates The preparation of condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, expense and related disclosures. The Company bases estimates and assumptions on historical experience and on various other factors that it believes to be reasonable under the circumstances. The Company evaluates its estimates and assumptions on an ongoing basis. The Company's actual results may differ from these estimates under different assumptions or conditions.

Revisions to Amounts Previously Presented Certain prior period amounts have been reclassified to conform to the current period presentation. Deferred costs for the year ended December 31, 2010 relating to costs of product shipments where title has passed to the customer but not all of the revenue recognition criteria have been met, have been reclassified from inventory to deferred costs in the condensed consolidated balance sheets and condensed consolidated statements of cash flows.

Government Grants The Company recognizes government grants when there is reasonable assurance that the Company will comply with the conditions attached to the grant arrangement and the grant will be received. Government grants are recognized in the condensed consolidated statements of operations on a systematic basis over the periods in which the Company recognizes the related costs for which the government grant is intended to compensate. Specifically, when government grants are related to reimbursements for cost of revenues or operating expenses, the government grants are recognized as a reduction of the related expense in the condensed consolidated statements of operations. For government grants related to reimbursements of capital expenditures, the government grants are recognized as a reduction of the basis of the asset and recognized in the condensed consolidated statements of operations over the estimated useful life of the depreciable asset as reduced depreciation expense.

The Company records government grants receivable in the condensed consolidated balance sheets in prepaid expenses and other current assets or long-term grant receivable, depending on when the

A123 Systems, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

1. Nature of the Business, Basis of Presentation, and Significant Accounting Policies (Continued)

amounts are expected to be received from the government agency. The Company does not discount long-term grant receivables. Proceeds received from government grants prior to expenditures being incurred are recorded as short-term or long-term restricted cash and other current liabilities or other long-term liabilities, depending on when the Company expects to use the proceeds.

The Company classifies in the condensed consolidated statements of cash flows grant proceeds received in advance of spending for qualified expenditures as a cash flow from financing activities, as the proceeds are used to assist in funding future expenditures. Grant proceeds received as reimbursements for capital expenditures previously incurred are classified in cash flows from investing activities and grant proceeds received as reimbursements for operating expenditures previously incurred are classified in cash flows from operating activities.

Revenue Recognition The Company recognizes revenue from the sale of products and delivery of services, including those products and services sold under governmental contracts. Revenue is recognized when all of the following criteria are met: persuasive evidence of an arrangement exists, delivery has occurred or services have been provided, the price to the buyer is fixed or determinable, and collectability is reasonably assured. When collectability is not reasonably assured, the Company will record a receivable and defer the revenue and costs associated with the delivered product or services until cash is received from the customer.

If a sales arrangement contains multiple elements, the Company evaluates the agreement to determine if separate units of accounting exist within the arrangement. If separate units of accounting exist within the arrangement, the Company allocates revenue to each element based on the relative selling price of each of the elements.

The Company's multiple element arrangements typically include prototypes, production units and/or engineering and design services. Generally, provided all other revenue recognition criteria have been met, the Company recognizes revenue from prototype and production units upon shipment to the customer and revenue from engineering and design services upon the completion of milestones based on the proportional performance method or based on the completed contract method if the Company does not have the ability to reasonably estimate contract costs or progress toward completion of the contract. The Company's customers may generally cancel orders at any time prior to product shipment.

Each deliverable within a multiple-element revenue arrangement is accounted for as a separate unit of accounting if both of the following criteria are met: (1) the delivered item or items have value to the customer on a standalone basis, and (2) for an arrangement that includes a general right of return relative to the delivered item(s), delivery or performance of the undelivered item(s) is considered probable and substantially in the Company's control. The Company considers a deliverable to have standalone value if the Company sells this item separately, if the item is sold by another vendor, or if the item could be resold by the customer. Further, the Company's revenue arrangements generally do not include a general right of return relative to delivered products. Deliverables that do not meet the criteria for being a separate unit of accounting are combined with a deliverable that does meet that criterion. The appropriate allocation of arrangement consideration and recognition of revenue is then determined for the combined unit of accounting.

The Company allocates arrangement consideration to each deliverable in an arrangement based on its relative selling price. The Company determines selling price using vendor-specific objective evidence

Table of Contents

A123 Systems, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

1. Nature of the Business, Basis of Presentation, and Significant Accounting Policies (Continued)

("VSOE"), if it exists; otherwise, the Company uses third-party evidence ("TPE"). If neither VSOE nor TPE of selling price exists for a unit of accounting, the Company uses estimated selling price ("ESP").

VSOE is generally limited to the price charged when the same or similar product is sold separately. If a product or service is seldom sold separately, it is unlikely that the Company can determine VSOE for the product or service. In most cases, VSOE of selling price is an average price of recent actual transactions that are priced within a reasonable range. TPE is determined based on the prices charged by the Company's competitors for a similar deliverable when sold separately. It may be difficult for the Company to obtain sufficient information on competitor pricing to substantiate TPE and, therefore, the Company may not always be able to use TPE.

If the Company is unable to establish selling price using VSOE or TPE, and the new or materially modified arrangement was entered into after January 1, 2010, the Company will use ESP in the allocation of arrangement consideration. The objective of ESP is to determine the price at which the Company would transact if the product or service were sold on a standalone basis. The Company's determination of ESP involves a weighting of several factors based on the specific facts and circumstances of the arrangement. Because of the nature of the business and history with providing services and manufacturing products for various applications, the Company performs an initial assessment on the nature of the services that will be provided by estimating the cost to provide those services plus an estimated profit margin. The Company performs the same assessment on new products by estimating the per unit cost to manufacture the product plus an estimated profit margin. The estimated profit margins initially used in the assessment are based on the Company's profit objectives which will be adjusted based on other considerations such as pricing of similar products and services, characteristics of the specific market, ongoing pricing strategy and policies and value of any enhancements in functionality included in the deliverable.

The Company plans to analyze the selling prices used in the allocation of arrangement consideration at a minimum on an annual basis. Selling prices will be analyzed on a more frequent basis if a significant change in the business necessitates a more timely analysis or if the Company experiences significant variances in selling prices.

Product Revenue

Product revenue is generally recognized upon transfer of title and risk of loss, which is generally upon shipment, unless an acceptance period exists. In general, the Company's customary shipping terms are FOB shipping point or free carrier. In instances where customer acceptance of a product is required, revenue is either recognized (i) upon shipment when the Company is able to demonstrate that the customer specific objective criteria have been met or (ii) upon the earlier of customer acceptance or expiration of the acceptance period.

The Company provides warranties for its products and records the estimated costs as a cost of revenue in the period the revenue is recorded. The Company's standard warranty period extends one to eight years from the date of delivery, depending on the type of product purchased and its application. The warranties provide that the Company's products will be free from defects in material and workmanship and will, under normal use, conform to the specifications for the product. The warranties further provide that the Company will repair the product or provide replacement parts at no charge to the customer. The Company's warranty liability is based on projected product failure rates and estimated costs of fulfilling warranty claims. Projections are based on the Company's actual warranty

Table of Contents

A123 Systems, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

1. Nature of the Business, Basis of Presentation, and Significant Accounting Policies (Continued)

experience and other known factors. The Company monitors its warranty liability and adjusts the amounts as necessary. When the Company is unable to reasonably determine its obligation for warranty of new products, revenue from the sale of the products is deferred until expiration of the warranty period or until such time as the warranty obligation can be reasonably estimated.

In instances where the Company has deferred revenue under various arrangements, the Company also defers the associated costs of revenue until such time that it is able to recognize the revenue.

Services Revenue

Revenue from services is recognized as the services are performed consistent with the performance requirements of the contract using the proportional performance method if the Company is able to reasonably estimate the contract cost and progress toward completion of the contract. Where arrangements include milestones or governmental approval that impact the fees payable to the Company, revenue is limited to those amounts whereby collectability is reasonably assured. The Company recognizes revenue earned under time and materials contracts as services are provided based upon actual costs incurred plus a contractually agreed-upon profit margin. The Company recognizes revenue from fixed-price contracts using the proportional performance method based on the ratio of costs incurred to estimates of total expected project costs if reasonably dependable estimates of the revenues and costs applicable to various stages of a contract can be made. Estimates made are based on historical experience and deliverables identified in the contract and are indicative of the level of benefit provided to the Company's clients. Project costs are based on the direct salary and associated fringe benefits of the employees on the project plus all direct expenses incurred to complete the project including sub-contractual and equipment costs where the Company is the principal in the arrangement. Under the proportional performance method, there are no costs that are deferred and amortized over the contract term. If the Company does not have the ability to reasonably estimate contract costs or progress toward completion of the contract, the Company defers the related revenue and costs and recognizes the revenues and costs based on the completed contract method.

Service revenue includes revenue derived from the execution of contracts awarded by the U.S. federal government, other government agencies and commercial customers. The Company's research and development arrangements with the federal government or other government agencies typically require the Company to provide pure research, in which the Company investigates design techniques on new battery technologies. The Company's arrangements with commercial customers consist of arrangements where the Company is paid to enhance or modify an existing product or to develop or jointly develop a new product to meet a customer's specifications.

Table of Contents

A123 Systems, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

1. Nature of the Business, Basis of Presentation, and Significant Accounting Policies (Continued)

Deferred Revenue

The Company records deferred revenue for product sales and services revenue in several different circumstances. These circumstances include when (i) the Company has delivered products or performed services but other revenue recognition criteria have not been satisfied, (ii) payments have been received in advance of products being delivered or services being performed and (iii) all other revenue recognition criteria have been met, but the Company is not able to reasonably estimate the warranty expense. Deferred revenue includes customer deposits and up-front fees associated with services arrangements. Deferred revenue expected to be recognized as revenue more than one year subsequent to the balance sheet date is classified as long-term deferred revenue. Deferred revenue will vary depending on the timing and amount of cash receipts from customers and can vary significantly depending on specific contractual terms.

On November 17, 2008, the Company entered into an exclusive agreement to license certain of its technology in the field of consumer electronics devices (excluding power tools and certain other consumer products). In connection with the license agreement and modification, the Company has received and recorded as deferred revenue an up-front license, support and additional fees totaling $28.0 million. In addition, the agreement provides that the Company will be paid royalty fees on net sales of licensed products that include its technology. The Company has agreed to the terms of the license agreement that if, during a certain period following execution of the license agreement, the Company enters into an agreement with a third party that materially restricts the licensee's rights under the license agreement or fails to provide the necessary support to enable the licensee to practice the Company's technology, then the Company may be required to refund the licensee all license and support fees paid to cover the licensee's capital and other expenses paid and/or committed by the licensee in reliance upon its rights under the license agreement. On April 29, 2011, the transfer of technology was completed, which allowed the Company to begin recognizing revenue on the license and support fee over the longer of the patent term or the expected customer relationship, which is 20 years.

Production start-up Production start-up expenses consist of manufacturing salaries and personnel-related costs, site selection costs, including legal and regulatory costs, rent and the cost of operating a production line before it has been qualified for production, including the cost of raw materials run through the production line during the qualification phase. During the three and nine months ended September 30, 2010 and 2011, the Company incurred production start-up expenses related to its facility in Romulus, Michigan and related to the second production line in its facility in Livonia, Michigan. During the three and nine months ended September 30, 2010, the Company also incurred production start-up expenses related to its first production line in the Livonia facility. The Livonia facility began qualification for production in the third quarter of 2010 and the first production line was qualified in December 2010. Since qualification, expenses related to the first production line in the Livonia facility are no longer included in production start-up expenses. The second production line in the Livonia facility was qualified in July 2011. The Romulus facility began qualification for production in the first quarter of 2011 and is expected to be qualified in the fourth quarter of 2011. The Company expects to continue to incur production start-up expenses related to the Romulus facility until the facility is qualified in the near term. A portion of production start-up expenses was offset primarily by

A123 Systems, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

1. Nature of the Business, Basis of Presentation, and Significant Accounting Policies (Continued)

government grant funding. The following table presents production start-up expenditures included in the Company's condensed consolidated statements of operations (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2011	2010	2011
Production start-up expenditures				
Aggregated production start-up expenditures	$ 15,603	$ 1,851	$ 22,490	$ 13,792
Production start-up reimbursements	(3,852)	(754)	(5,322)	(4,577)
Production start-up expenses	$ 11,751	$ 1,097	$ 17,168	$ 9,215

Fair Value of Financial Instruments As of December 31, 2010 and September 30, 2011, except for the convertible notes outstanding as of September 30, 2011, the carrying amount of all financial instruments approximate their fair values. The carrying amount of cash and cash equivalents, restricted cash and cash equivalents, accounts receivable, accounts payable and accrued expenses approximates fair value due to the short-term nature of these items. Management believes that the Company's debt obligations, except for the convertible notes outstanding as of September 30, 2011, and the Company's capital lease obligations accrue interest at rates which approximate prevailing market rates for instruments with similar characteristics and, accordingly, the carrying values for these instruments approximate fair value. Investments are accounted for using the cost or equity method. The Company's outstanding convertible notes have an estimated fair value of $96.9 million as of September 30, 2011 based on available market data. As of September 30, 2011, the convertible notes had a carrying value of $139.9 million reflected in long-term debt in the Company's condensed consolidated balance sheet, which reflects the face amount of $143.8 million, net of the unamortized discount of $3.9 million.

Fair value is an exit price, representing the amount that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, GAAP establishes a three-tier value hierarchy, which prioritizes the inputs used in measuring fair value as follows: (Level 1) observable inputs such as quoted prices in active markets; (Level 2) inputs other than the quoted prices in active markets that are observable either directly or indirectly; and (Level 3) unobservable inputs in which there is little or no market data, which requires the Company to develop its own assumptions. This hierarchy requires the Company to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value. On a recurring basis, the Company measures certain financial assets and liabilities at fair value, including the Company's cash equivalents.

Items Measured at Fair Value on a Nonrecurring Basis During the three and nine months ended September 30, 2011, long-lived assets at the Company's China and Korean facilities with an aggregate carrying value of $0 and $2.6 million, respectively, were written down to their net realizable value, resulting in an asset impairment charge of $0 and $2.6 million, respectively. This adjustment was determined by comparing the estimated value of the assets (calculated using Level 3 inputs) to the asset's carrying value. There were no material items measured at fair value on a nonrecurring basis as of December 31, 2010.

Table of Contents

A123 Systems, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

1. Nature of the Business, Basis of Presentation, and Significant Accounting Policies (Continued)

Items Measured at Fair Value on a Recurring Basis The following tables show assets measured at fair value on a recurring basis and the input categories associated with those assets (in thousands):

	As of December 31, 2010			
	Fair Value at December 31, 2010	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Asset:				
Money market funds	$ 174,603	$ 174,603	$	$
U.S. Treasury and government agency securities	17,333		17,333	

	As of September 30, 2011			
	Fair Value at September 30, 2011	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Assets:				
Money market funds	$ 165,619	$ 165,619	$	$

Cash and cash equivalents include investments in money market fund investments that are measured at fair value on a recurring basis based on quoted prices in active markets for identical assets. As of December 31, 2010, the Company held investments in U.S. Treasury and government agency securities that were classified as either cash equivalents or restricted cash equivalents and were measured at fair value based on inputs (other than quoted prices) that are observable for securities, either directly or indirectly.

Stock-Based Compensation The Company accounts for all awards, including employee and director awards, by recognizing compensation expense based on the fair value of share-based transactions in the condensed consolidated financial statements. The Company recognizes compensation expense over the vesting period using a ratable method (providing the minimum amount of compensation recorded is equal to the vested portion of the award, requiring a ratable method when necessary) and classifies these amounts in the condensed consolidated statements of operations based on the department to which the related employee reports. The Company uses the Black-Scholes valuation model to calculate the fair value of stock options, utilizing various assumptions.

Net Loss Per Share Basic net loss per share is computed by dividing net loss by the weighted-average number of common shares outstanding during the fiscal year. Diluted net loss per share is computed by dividing net loss by the weighted-average number of dilutive common shares outstanding during the fiscal year. Dilutive shares outstanding are calculated by adding to the weighted shares outstanding any potential (unissued) shares of common stock and warrants based on the treasury stock method.

Table of Contents

A123 Systems, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

1. Nature of the Business, Basis of Presentation, and Significant Accounting Policies (Continued)

The following potentially dilutive securities were excluded from the calculation of diluted net loss per share, as the effect would have been anti-dilutive (in thousands):

	September 30,	
	2010	2011
Convertible debt upon conversion to common stock		19,965
Warrants to purchase common stock	45	45
Options to purchase common stock	10,764	11,219
Unvested restricted stock units	203	1,361
	11,012	32,590

2. Government Grants

Center of Energy and Excellence Grant

In February 2009, the State of Michigan awarded the Company a $10.0 million Center of Energy and Excellence grant. Under the agreement, the State of Michigan will provide cost reimbursement for 100% of qualified expenditures incurred through November 30, 2011. There are no substantive conditions attached to this award that would require repayment of amounts received if such conditions were not met. The Company received $3.0 million of this grant in March 2009 and $6.0 million of this grant in July 2010, with additional payments to be made based on the achievement of certain milestones in the facility development. Through September 30, 2011, the Company has used $8.3 million of these funds, of which $7.9 million and $0.4 million was recorded as an offset to property, plant and equipment and operating expenses, respectively. For the three months ended September 30, 2010 and 2011 and the nine months ended September 30, 2010 and 2011, $0.1 million, $0, $0.2 million and $0.1 million was recorded as an offset to operating expenses in the condensed consolidated statements of operations, respectively. As of December 31, 2010 and September 30, 2011, $0.8 million and $0.7 million of these funds are recorded in short-term restricted cash and other current liabilities on the condensed consolidated balance sheets, respectively.

Michigan Economic Growth Authority

In April 2009, the Michigan Economic Growth Authority offered the Company certain tax incentives, which can be used to offset the Michigan Business Tax owed in a tax year, carried forward for the number of years specified by the agreement, or be paid to the Company in cash at the time claimed to the extent the Company does not owe a tax. The terms and conditions of the *High-Tech Credit* were established in October 2009 and the *Cell Manufacturing Credit* in November 2009.

High Tech Credit The *High-Tech Credit* agreement provides the Company with a 15-year tax credit, based on qualified wages and benefits multiplied by the Michigan personal income tax rate beginning with payments made for the 2011 fiscal year. The tax credit has an estimated value of up to $25.3 million, depending on the number of jobs created in Michigan. The proceeds to be received by the Company will be based on the number of jobs created, qualified wages paid and tax rates in effect over the 15 year period. The tax credit is subject to a repayment provision in the event the Company relocates a substantial portion of the jobs outside the state of Michigan on or before December 31, 2026. As of September 30, 2011, $1.0 million was recorded as an undiscounted receivable in long-term

Table of Contents

A123 Systems, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

2. Government Grants (Continued)

grant receivable with an offsetting balance in other long-term liabilities in the condensed consolidated balance sheet as it is reasonably assured that the Company will comply with the conditions of the tax credit and will receive the proceeds. The balance will be recognized in the condensed consolidated statements of operations over the term that the Company is required to maintain the required number of jobs in Michigan.

Cell Manufacturing Credit The *Cell Manufacturing Credit* agreement authorizes a tax credit or cash for the Company equal to 50% of capital investment expenses related to the construction of the Company's integrated battery cell manufacturing facilities in Michigan, commencing with costs incurred from January 1, 2009, up to a maximum of $100.0 million over a four year period. The tax credit shall not exceed $25.0 million per year and can be submitted for reimbursement beginning in tax year 2012. The Company is required to create 300 jobs no later than December 31, 2016 for the tax credit to be non-refundable. The tax credit is subject to a repayment provision in the event the Company relocates 51% or more of the 300 jobs outside of the state of Michigan within three years after the last year the tax credit is received. Through September 30, 2011, the Company has incurred $197.0 million in qualified expenses related to the construction of the Livonia and Romulus facilities. When the Company has met the filing requirements for the tax year ending December 31, 2012, the Company expects to begin receiving $98.5 million in proceeds related to these expenses. As of December 31, 2010 and September 30, 2011, the Company has recorded undiscounted receivables of $75.8 million and $98.5 million, as it is reasonably assured that the Company will comply with the conditions of the tax credit and will receive the proceeds. Upon recording the receivables, the Company reduced the basis in the fixed assets acquired in accordance with the tax credit and this will be recognized in the condensed consolidated statements of operations over their estimated useful lives of the depreciable asset as reduced depreciation expense.

U.S. Department of Energy Battery Initiative

In December 2009, the Company entered into an agreement establishing the terms and conditions of a $249.1 million grant awarded under the U.S. Department of Energy ("DOE") Battery Initiative to support manufacturing expansion of new lithium-ion battery manufacturing facilities in Michigan. Under the agreement, the DOE will provide cost reimbursement for 50% of qualified expenditures incurred from December 1, 2009 to November 30, 2012. The agreement also provides for reimbursement of pre-award costs incurred from June 1, 2009 to November 30, 2009. There are no substantive conditions attached to this award that would require repayment of amounts received if such conditions were not met. Through September 30, 2011, the Company has incurred $249.8 million in qualified expenses, of which 50%, or $124.9 million, are allowable costs for reimbursement, nearly all of which have been reimbursed. For the three months ended September 30, 2010 and 2011, the Company incurred allowable costs of $24.9 million and $8.0 million, of which $1.6 million and $2.8 million was recorded as an offset to operating expenses, respectively. For the nine months ended September 30, 2010 and 2011, the Company incurred allowable costs of $47.3 million and $35.9 million, of which $3.3 million and $9.2 million was recorded as an offset to operating expenses, respectively. As of December 31, 2010 and September 30, 2011, the Company recorded $2.1 million and $1.8 million, respectively, as receivables in prepaid expenses and other current assets in the condensed consolidated balance sheets.

A123 Systems, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

3. Inventory

Inventory consists of the following (in thousands):

	December 31, 2010	September 30, 2011
Raw materials	$ 18,929	$ 37,372
Work-in-process	27,226	59,394
Finished goods	1,610	2,727
	$ 47,765	$ 99,493

The Company's lower of cost or market reserve as of December 31, 2010 and September 30, 2011 was $2.2 million and $4.5 million, respectively. The lower of cost of market reserve is recorded for specific inventory items on hand with unit costs that exceed their net realizable value. The net realizable value of inventory is calculated by taking the estimated selling price of the inventory on hand based on customer contracts and forecasted sales and subtracting the remaining costs to complete and dispose of the inventory.

4. Property, Plant and Equipment

For government grants related to capital expenditures, the Company recognizes the reimbursement as a reduction of the basis of the asset and a reduction to depreciation expense over the useful life of the asset. Property, plant and equipment consists of the following (in thousands):

	December 31, 2010	September 30, 2011
Computer equipment and software	$ 11,913	$ 20,814
Furniture and fixtures	3,415	5,535
Automobiles	404	485
Machinery and equipment	122,187	192,105
Buildings	26,810	25,844
Leasehold improvements	34,540	59,189
Property, plant and equipment not in service	154,357	134,128
Property, plant and equipment, basis	353,626	438,100
Less reduction for costs reimbursed under government grants	164,999	218,021
Property, plant and equipment, carrying value	188,627	220,079
Less accumulated depreciation, net	44,629	58,966
Property, plant and equipment, net	$ 143,998	$ 161,113

A123 Systems, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

4. Property, Plant and Equipment (Continued)

The Company has deposits for equipment not yet received of $11.6 million and $8.4 million at December 31, 2010 and September 30, 2011, respectively, included within deposits and other assets in the condensed consolidated balance sheets. These deposits are reported net of contra deposit balances related to reimbursements under government grants of $1.7 million and $2.2 million at December 31, 2010 and September 30, 2011, respectively.

Property, plant and equipment under capital lease consists of the following (in thousands):

	December 31, 2010	September 30, 2011
Computer equipment and software, at cost	$ 2,758	$ 2,910
Buildings, at cost	16,446	16,446
Leasehold improvements, at cost	2,091	2,091
Accumulated depreciation	(1,631)	(3,599)
Property, plant and equipment under capital lease, net	$ 19,664	$ 17,848

Net depreciation expense for the three months ended September 30, 2010 and 2011 and for the nine months ended September 30, 2010 and 2011 was $4.4 million, $7.5 million, $11.9 million and $18.1 million, respectively. For the three months ended September 30, 2010 and 2011 and for the nine months ended September 30, 2010 and 2011, the Company recorded $0.3 million, $4.2 million, $0.4 million and $10.3 million, respectively, as a reduction to depreciation expense related to reduced carrying value due to government grant reimbursements.

5. Investments

Cost-Method Investments

In January 2010, the Company entered into an agreement to purchase preferred stock of a maker of plug-in hybrid electric vehicles in the United States (the "Automaker"). The Company agreed to invest (i) cash of $13.0 million; and (ii) shares of the Company's common stock, which, when transferred to the Automaker, had a fair market value of $7.5 million. As of December 31, 2010 and September 30, 2011, the Company has recorded an investment of $20.5 million in the condensed consolidated balance sheets. The Company is accounting for its investment under the cost method. Through September 30, 2011, there have been no changes in circumstances that may have a significant adverse effect on the fair value of the investment.

Equity-Method Investments

In December 2009, the Company entered into a joint venture agreement with an automaker in China to assist the Company in growing its business and sales in China's transportation industry and created Shanghai Advanced Traction Battery Systems, Co. Ltd. (the "Joint Venture"). Under the terms of the joint venture agreement, the Company was required to invest $4.7 million into the Joint Venture over a period of approximately 15 months, in return for a 49% interest in the Joint Venture. The Company made the first capital contribution of $1.9 million to the Joint Venture in July 2010 and the second capital contribution of $1.4 million in January 2011. The Company made the final capital contribution of $1.4 million in July 2011. The Company is accounting for its investment under the equity method.

A123 Systems, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

5. Investments (Continued)

In August 2010, the Company entered into an agreement to transfer certain patents held by the Company to a privately-held company, 24M Technologies, Inc. ("24M"), in return for a 12% ownership interest in 24M. The Company is accounting for its investment under the equity method as it has determined it has significant influence over the operating and financial decisions of the third party. The Company has recorded the investment on the condensed consolidated balance sheet at the fair value of the ownership interest received net of accumulated losses recognized under the equity method.

For the three and nine months ended September 30, 2011, the Company recorded a loss of $0.1 million and $0.7 million, respectively in the consolidated statements of operations related to its share of losses in investments accounted for under the equity method. The Company recorded a $0.2 million gain related to its investments accounted for under the equity method in the three and nine months ended September 30, 2010.

6. Commitments and Contingencies

Litigation In November 2005, the Company received a letter asserting that it was infringing upon certain U.S. patents. In April 2006, the Company commenced an action in the United States District Court for the District of Massachusetts seeking a declaratory judgment that the patents in question were not infringed by the Company's products and that the patents claiming to be infringed upon are invalid. On September 11, 2006, a countersuit was filed against the Company and two of its business partners in the United States District Court for the Northern District of Texas alleging infringement of these patents. In October 2006 and January 2007, the U.S. Patent and Trademark Office ("PTO") granted the Company's request for reexamination of the two patents. In January and February 2007, the two suits were stayed pending the reexamination. The reexaminations of the two patents were concluded on April 15, 2008 and May 12, 2009, respectively. As a result, the scope of the claims in each patent were narrowed from those of the original claims made. The Company filed a motion to re-open the litigation in the United States District Court for the District of Massachusetts on June 11, 2009. On September 28, 2009, the Massachusetts court entered an order denying that motion, which the Company appealed on October 27, 2009 to the United States Court of Appeals for the Federal Circuit. The United States Court of Appeals for the Federal Court upheld the Massachusetts Court's decision on November 10, 2010. On July 22, 2009, the Company was sent a proposed Second Amended Complaint which the complainants intend to seek leave to file with the Texas court in light of the PTO's reexaminations. On August 27, 2009, Hydro-Quebec and The University of Texas ("UT") filed a Motion for Leave to File Second Amended Complaint and Jury Demand in the United States District Court for the Northern District of Texas and the Company was granted several unopposed extensions to file its response. Hydro-Quebec and UT filed for leave to file an Amended Motion for Leave to File Second Amended Complaint and Jury Demand on April 1, 2010 and the Company filed its opposition to this application on April 22, 2010. On June 7, 2011, Hydro-Quebec filed a new complaint in the United States District Court for the Northern District of Texas against the Company and other companies alleging infringement of a newly-issued continuation patent to one of the patents in the existing action. Hydro-Quebec has amended this complaint to include three additional continuation patents that have subsequently issued.

On June 27, 2011, the parties engaged in a court ordered mediation session in New York City before the Honorable John Lifland, a retired federal judge. On October 31, 2011, the Company entered into a Settlement Agreement and related Patent Sublicense Agreement with Hydro-Quebec and the Board of Regents of the University of Texas System, on behalf of the University of Texas at

A123 Systems, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

6. Commitments and Contingencies (Continued)

Austin. See Note 10 Subsequent Events. As of September 30, 2011, the Company accrued for an estimated settlement of $5.0 million related to this lawsuit which is recorded within general and administrative expense in the condensed consolidated statement of operations. The Company recorded $3.5 million in accrued expenses and the remaining $1.5 million which is expected to be paid in two equal installments in 2013 and 2014 were recorded in other long-term liabilities in the condensed consolidated balance sheet.

7. Financing Arrangements

Long-Term Debt Long-term debt consists of the following (in thousands):

	December 31, 2010	September 30, 2011
Convertible notes	$	$ 139,850
Term loan	7,069	3,319
Mass Clean Energy loan	2,534	2,651
Korean subsidiary debt		
Technology funds loan	44	
Korean government loans	335	101
Total	9,982	145,921
Less amounts classified as current	5,379	3,421
Long-term debt	$ 4,603	$ 142,500

Convertible Notes In April 2011, the Company issued $143.8 million in principal of convertible unsecured subordinated notes (the "Convertible Notes"). The Convertible Notes bear interest at 3.75%, which is payable semi-annually in arrears on April 15 and October 15 each year, beginning on October 15, 2011, and mature on April 15, 2016. Holders may surrender their Convertible Notes, in integral multiples of $1,000 principal amount, for conversion any time prior to the close of business on the business day immediately preceding the maturity date. The initial conversion rate of 138.8889 shares of common stock per $1,000 aggregate principal amount of Convertible Notes, equivalent to a conversion price of approximately $7.20 per share of the Company's common stock, is subject to adjustment in certain events. Upon conversion, the Company will deliver shares of common stock. If the Company undergoes a fundamental change (as defined in the prospectus supplement relating to the Convertible Notes), the holders of the Convertible Notes have the option to require the Company to repurchase all or any portion of their Convertible Notes. The Company may not redeem the convertible notes prior to the maturity date.

The Company recorded a debt discount to reflect the value of the underwriter's discounts and commissions. The debt discount is being amortized as interest expense over the term of the Convertible Notes. As of September 30, 2011, the unamortized discount was $3.9 million and the carrying value of the Convertible Notes, net of the unamortized discount, was $139.9 million. During the three months ended September 30, 2011, the Company recognized interest expense of $1.6 million related to the Convertible Notes, of which $1.4 million and $0.2 million relate to the contractual coupon interest accrual and the amortization of the discount, respectively.

Table of Contents

A123 Systems, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

7. Financing Arrangements (Continued)

Term Loan The Company has an agreement with a financial institution for a term loan facility of $15.0 million. The term loan facility is repayable over a 36-month period and accrues interest at the financial institution's prime rate (which was 4.0% at December 31, 2010 and September 30, 2011) plus 0.75%. This term loan facility matures in September 2012. The term loan agreement is collateralized by substantially all assets of the Company, excluding intellectual property, property and equipment owned as of December 31, 2005 and certain equipment located in China.

The term loan agreement requires the Company to comply with certain covenants, which include a minimum liquidity ratio calculation. Additionally, the Company may not create, incur, assume or be liable for indebtedness, except for permitted indebtedness or create, incur or allow any lien on its property, except for permitted liens. Under the term loan agreement, an event of default would occur if the Company fails to pay any obligation due or fails or neglects to perform, keep or observe any material term provision, condition, covenant or agreement within the term loan agreement, and does not, or is not able to cure the default within the allowed grace period, or a material adverse change in the Company's business occurs. Upon an event of default, the financial institution may declare all obligations immediately due and payable, it may stop advancing money or extending credit or it may apply against the obligation balances and deposits which the Company holds with the financial institution, among other remedies available to the financial institution under the terms of the term loan agreement.

Mass Clean Energy Loan The Company has a forgivable loan from the Massachusetts Clean Energy Technology Center for $5.0 million. If the Company complies with certain capital expenditure conditions, $2.5 million of the loan will be forgiven and if the Company complies with certain employment conditions an additional $2.5 million will be forgiven. As of December 31, 2010 and September 30, 2011, $2.5 million is recorded as an offset to property, plant and equipment in the condensed consolidated balance sheets as the Company is reasonably assured that the Company will comply with the conditions for the forgiveness related to the capital expenditure condition. On October 18, 2011, an amendment to the Loan and Security Agreement was executed forgiving $2.5 million of the loan and all accrued interest thereon as the Company has met the capital expenditure conditions. As of December 31, 2010 and September 30, 2011, the remaining $2.5 million is recorded as long-term debt as the Company is not reasonably assured that it will comply with the employment conditions. The loan has a fixed interest rate of 6.0%, and all funds borrowed under the agreement, together with accrued interest is due upon maturity in October 2017 if the Company has not complied with the forgiveness conditions. See Note 10 Subsequent Events.

Korean debt The Company has the following outstanding obligations for its Korean subsidiary:

Technology funds loan The Company had a technology funds loan agreement with a variable interest rate. The weighted average interest rate for the loan at maturity in August 2011 was 3.12%.

Korean government loans As a part of the Korean government's initiative to promote and encourage the development of start-up companies in certain high technology industries, high technology start-up companies with industry leading technology or products are eligible for government loans. Certain grants are refundable, depending on the successful development and commercialization of the technology or products, and a company receiving such government grants is required to refund between 20% and 30% of the grants received for such development.

Table of Contents

A123 Systems, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

7. Financing Arrangements (Continued)

Revolving Credit Facilities On September 30, 2011, the Company entered into a Revolving Credit Agreement (the "Agreement"), providing the Company a revolving loan facility in an aggregate principal amount of up to the lesser of (i) $40.0 million or (ii) a Borrowing Base (as defined in the Agreement) established at 80% of certain eligible accounts, 15% of certain eligible foreign accounts and 30% of certain eligible inventory, as more specifically described in the Agreement. The Agreement also provides a letter of credit sub-facility in an aggregate principal amount of up to $10.0 million and a swing-line loan sub-facility in an aggregate principal amount of up to $5.0 million. Any outstanding obligations under either the letter of credit sub-facility or swing-line sub-facility deduct from the availability under the $40.0 million revolving facility. The Agreement additionally provides a discretionary incremental facility in an aggregate principal amount of not less than $10.0 million and up to $35.0 million. The funding of the incremental facility is discretionary on the part of the Lenders and will depend on market conditions and other factors. The Agreement permits the Companies to enter into cash management and hedging agreements with the Lenders.

The facilities provided under the Agreement are to be used to refinance the Company's prior outstanding revolving loan facility with the financial institution, dated as of August 2, 2006, and for working capital and general corporate purposes. The maturity date for any revolving cash borrowings under the Agreement is September 30, 2014.

Revolving cash borrowings under the Agreement will bear interest at (i) the Eurodollar Rate (as defined in the Agreement), plus 0.225% (if the Company's liquidity is greater than $75.0 million) or 0.275% (if the Company's liquidity is equal to or less than $75.0 million) per annum, and/or (ii) the base rate (customarily defined), plus 0.50% (if the Company's liquidity is equal to or less than $75.0 million) per annum. The interest rate at September 30, 2011 is 2.87%.

Amounts outstanding under the Agreement (including any cash management or hedging agreements as provided in the Agreement) are secured by substantially all of the Company's existing and future assets, except intellectual property and certain other exceptions as set forth in the Agreement and related security documents.

The Agreement contains the following financial covenants:

(a) The Company must maintain (i) a Consolidated Liquidity Ratio (the Company's liquidity to all outstanding obligations under the Agreement, as more specifically defined in the Agreement) of at least 2.00 to 1.00, and (ii) the Company's liquidity at $50.0 million or above; and

(b) The Company's Consolidated Tangible Net Worth (as defined in the Agreement) must be at least $400.0 million.

Additionally, the Company may not create, issue, incur, assume or be liable in respect of or suffer to exist, any indebtedness, except for permitted indebtedness or create, incur, assume or suffer to exist, any lien on its property, except for permitted liens. Under the credit agreement, an event of default would occur if the Company fails to pay any obligation due or fails or neglects to perform, keep or observe any material term provision, condition, covenant or agreement within the credit agreement, and does not, or is not able to remedy the default within the allowed grace period, or a material adverse change in the Company's business occurs. Upon an event of default, the financial institution may declare all obligations immediately due and payable, it may stop advancing money or extending credit or it may apply against the obligation balances and deposits which the Company holds with the

A123 Systems, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

7. Financing Arrangements (Continued)

financial institution, among other remedies available to the financial institution under the terms of the credit agreement.

The outstanding balance on the Company's outstanding credit facilities at December 31, 2010 and September 30, 2011 was $8.0 million and $38.0 million, respectively.

8. Stock-Based Compensation

During 2009, the Company's Board of Directors approved the 2009 Stock Incentive Plan (the "2009 Plan") which became effective on the closing of the Company's initial public offering ("IPO") on September 24, 2009. The 2009 Plan originally provided for the grant of qualified incentive stock options and nonqualified stock options or other awards to the Company's employees, officers, directors, and outside consultants. Up to an aggregate of 3,000,000 shares of Company's common stock, subject to increase on an annual basis, are reserved for future issuance under the 2009 Plan. During 2010, shares of common stock reserved for issuance under the Company's 2001 Stock Incentive Plan (the "2001 Plan") that remained available for issuance immediately prior to closing of the IPO and any shares of common stock subject to awards under the 2001 Plan that expired, terminated, or were otherwise forfeited, canceled or repurchased by the Company prior to being fully exercised were added to the number of shares available under the 2009 Plan, up to the maximum of 500,000 shares. On January 1, 2010 and 2011, 5,000,000 and 3,000,000 shares were added to the 2009 Plan in connection with the annual increases, respectively. As of September 30, 2011, the Company had 5,048,651 stock-based awards available for future grant under the 2009 Plan and no stock-based awards available for future grant under the 2001 Plan.

Stock-based compensation cost is measured at the grant date, based on the calculated fair value of the award, and is recognized as an expense over the service period (generally the vesting period of the equity grant). The Company estimates forfeitures at the time of grant and revises the estimates, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The following table presents stock-based compensation expense included in the Company's condensed consolidated statements of operations (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	**2011**	**2010**	**2011**
Cost of sales	$ 571	$ 621	$ 1,464	$ 1,809
Research, development and engineering	1,293	1,383	3,365	4,005
Sales and marketing	300	454	695	1,372
General and administrative	1,085	1,232	2,858	3,225
Total	$ 3,249	$ 3,690	$ 8,382	$ 10,411

The Company has capitalized an immaterial amount of stock-based compensation as a component of inventory.

As of September 30, 2011, there was approximately $34.6 million of total unrecognized compensation cost related to non-vested stock-based compensation arrangements granted under the plans, which is expected to be recognized over a weighted-average period of 2.93 years.

A123 Systems, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

8. Stock-Based Compensation (Continued)

Stock Options The stock options generally vest over a four-year period and expire 10 years from the date of grant. Upon option exercise, the Company issues shares of common stock.

The following table summarizes stock option activity for the nine months ended September 30, 2011:

	Shares (In thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (In thousands)
Outstanding January 1, 2011	10,783	$ 7.64	7.41	$ 27,743
Granted	2,404	6.00		
Exercised	(638)	3.14		
Forfeited	(1,330)	9.39		
Outstanding September 30, 2011	11,219	$ 7.34	7.39	$ 3,798
Vested or expected to vest September 30, 2011	10,715	$ 7.31	7.30	$ 3,798
Options exercisable September 30, 2011	5,868	$ 6.57	6.05	$ 3,798

The Company estimates the fair value of stock options granted using the Black-Scholes option-pricing model and assumptions as to the fair value of the common stock on the grant date, expected term, expected volatility, risk-free rate of interest and an assumed dividend yield.

The Black-Scholes model assumptions for the period set forth below are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2011	2010	2011
Risk-free interest rate	2.0 - 2.4%	1.5 - 2.3%	2.0 - 3.3%	1.5 - 3.0%
Expected life	6.25 years	6.25 years	6.25 years	6.25 years
Expected volatility	74%	74%	74%	74%
Expected dividends	0%	0%	0%	0%

The Company derived the risk-free interest rate assumption from the U.S. Treasury's rates for U.S. Treasury zero-coupon bonds with maturities similar to those of the expected term of the awards being valued. The Company based the assumed dividend yield on its expectation of not paying dividends in the foreseeable future. The Company calculated the weighted average expected term of options using the simplified method as allowed by the Stock Compensation Subtopic of the Accounting Standards Codification. This decision was based on the lack of relevant historical data due to the Company's limited operating experience. In addition, due to the Company's limited historical data, the estimated volatility also reflects the application of the Stock Compensation Subtopic, incorporating the historical volatility of comparable companies with publicly-available share prices.

The weighted average grant date fair value of options granted during the three months ended September 30, 2010 and 2011 and the nine months ended September 30, 2010 and 2011 was $5.94, $3.32, $6.67 and $4.01, respectively. The intrinsic value of options exercised during the three months ended September 30, 2010 and 2011 and the nine months ended September 30, 2010 and 2011 was

A123 Systems, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

8. Stock-Based Compensation (Continued)

$1.4 million, $0.1 million, $24.2 million and $3.6 million, respectively. The Company received $0.8 million, $26,000, $3.1 million and $2.0 million in cash from option exercises during the three months ended September 30, 2010 and 2011 and the nine months ended September 30, 2010 and 2011, respectively.

Restricted Stock Units The Company's restricted stock unit awards generally vest over a four-year period and upon vesting the Company issues shares of common stock. The following table summarizes the Company's restricted stock unit award activity for the nine months ended September 30, 2011:

	Shares	Weighted Average Fair Value
	(In thousands)	
Non-vested January 1, 2011	203	$ 10.13
Granted	1,290	5.54
Vested	(58)	10.07
Forfeited	(74)	7.12
Non-vested September 30, 2011	1,361	$ 5.95

The fair value of restricted stock unit awards is determined based on the closing price of the Company's common stock on the Nasdaq Global Select Market on the grant date.

9. Related Party Transactions

Transactions with Joint Venture Partner's Affiliate In December 2009, the Company entered into a joint venture with an automaker in China (the "Chinese Automaker") to assist the Company in growing business and sales in China's transportation industry. The Company entered into two development agreements with the Chinese Automaker. During the three months ended September 30, 2010 and 2011 and the nine months ended September 30, 2010 and 2011, the Company recorded revenue related to the development and supply agreements with the Chinese Automaker of $0, $0, $1.3 million and $0.4 million, respectively. As of December 31, 2010 and September 30, 2011, $0.5 million and $0 is recorded in deferred revenue on the condensed consolidated balance sheets, respectively, related to the development and supply agreements. As of December 31, 2010 and September 30, 2011, the balance due from the Chinese Automaker was $1.9 million and $0.1 million, respectively, which is included within accounts receivable, net on the condensed consolidated balance sheets.

Table of Contents

A123 Systems, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

9. Related Party Transactions (Continued)

Transactions with Cost-Method Investment In January 2010, the Company entered into a supply agreement with the Automaker in which the Company also holds an investment of preferred stock. The Company recognizes revenue on product shipments to the Automaker, within the condensed consolidated statements of operations, when all revenue recognition criteria are met. During the three months ended September 30, 2010 and 2011 and the nine months ended September 30, 2010 and 2011, the Company recorded $0.7 million, $24.7 million, $0.9 million and $40.7 million of revenue from the Automaker, respectively. At December 31, 2010 and September 30, 2011, the Company has deferred $0.4 million and $4.7 million, respectively, of service and product revenue related to the development and supply agreement. The balance due from the Automaker as of December 31, 2010 and September 30, 2011, of $0.6 million and $25.3 million, respectively, is included within accounts receivable, net on the condensed consolidated balance sheets.

Transactions with Equity-Method Investment During March 2010, the Company entered into a technology license contract to license certain patents and technology to the Company's Joint Venture for the term of the Joint Venture, which extends to April 28, 2030. In conjunction with the license agreement, the Joint Venture paid the Company the first payment of the license fee of $1.0 million in July 2010. Revenue on the license fee will be amortized over the term of the license. Revenue recognition is expected to commence upon the successful completion of training provided to employees of the Joint Venture. As of December 31, 2010 and September 30, 2011, $1.0 million of the license fee is recorded in deferred revenue on the condensed consolidated balance sheets. During December 2010, the Company entered into a service agreement to provide technical development, design, analysis and consultation services to the Joint Venture. Additionally, the Company entered into an agreement to provide sample battery system packs to the Joint Venture. For the three and nine months ended September 30, 2011, the Company has recognized $1.9 million and $3.7 million of product and service revenue from the Joint Venture. The Company did not recognize any product or service revenue from the Joint Venture for the three and nine months ended September 30, 2010. At December 31, 2010 and September 30, 2011 the Company has deferred $0.2 million and $0.1 million, respectively, of service and product revenue related to the service agreement and initial sample shipments. As of December 31, 2010 and September 30, 2011, $0.5 million and $2.2 million are included within accounts receivable, net on the condensed consolidated balance sheets for amounts due from the Joint Venture.

10. Subsequent Events

On October 18, 2011, the first amendment to the Loan and Security Agreement between the Company and Massachusetts Clean Energy Technology Center related to the $5.0 million forgivable loan was executed forgiving $2.5 million of the loan and all accrued interest thereon as the Company has met the capital expenditure conditions. See Note 7 Financing Arrangements.

On October 31, 2011, the Company entered into a Settlement Agreement and related Patent Sublicense Agreement with Hydro-Quebec and the Board of Regents of the University of Texas System, on behalf of the University of Texas at Austin (UT) thereby settling the patent disputes and resolving all existing litigations among the parties. The parties have agreed to dismiss all litigations and grant the Company a license under the related patents. The settlement amount is consistent with the amount the Company has accrued as an estimated litigation settlement as of September 30, 2011. See Note 6 Commitments and Contingencies.

Table of Contents

A123 Systems, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

10. Subsequent Events (Continued)

On November 3, 2011, the Company entered into a Technology License Agreement (TLA), a Product Supply Agreement, and a Stock Purchase Agreement with IHI Corporation (IHI), a large industrial equipment manufacturer in Japan. Under the terms of the TLA, the Company will exclusively license to IHI for an initial term of 10 years its advanced battery system technology and systems integration know-how to manufacture battery systems and modules for the transportation market in Japan for a one-time, non-refundable license fee of $7.5 million. During the license term, the Company will also receive royalty payments from IHI based on a percentage of IHI's net sales of products that use or embody the licensed technology and know-how. The Company will be the exclusive supplier of lithium ion battery cells to IHI under the Product Supply Agreement for the battery systems and modules that IHI produces. IHI has also agreed to make a $25.0 million equity investment in the Company's common stock under the Stock Purchase Agreement, which will close on or about November 18, 2011 for a purchase price based on the average of the closing prices for the Company's common stock as reported on the NASDAQ Global Select Market during a period preceding the closing date.

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the condensed consolidated financial statements and the related notes thereto included elsewhere in this Quarterly Report on Form 10-Q and the audited consolidated financial statements and notes thereto and management's discussion and analysis of financial condition and results of operations for the year ended December 31, 2010 included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission, or SEC, on March 11, 2011. This Quarterly Report on Form 10-Q contains "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. These statements are often identified by the use of words such as "may," "expect," "believe," "anticipate," "intend," "could," "estimate," or "continue," and similar expressions or variations. Such forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in the section titled "Risk Factors," set forth in Part II, Item 1A of this Quarterly Report on Form 10-Q and elsewhere in this Quarterly Report. The forward-looking statements in this Quarterly Report on Form 10-Q represent our views as of the date of this Quarterly Report on Form 10-Q. We anticipate that subsequent events and developments will cause our views to change. However, while we may elect to update these forward-looking statements at some point in the future, we have no current intention of doing so except to the extent required by applicable law. You should, therefore, not rely on these forward-looking statements as representing our views as of any date subsequent to the date of this Quarterly Report on Form 10-Q.

Overview

We design, develop, manufacture and sell advanced, rechargeable lithium-ion batteries and battery systems. Our target markets are the transportation, electric grid services and commercial markets.

We market and sell our products primarily through a direct sales force. In the transportation market, we are focusing sales of our batteries and battery systems to automotive and heavy duty vehicle manufacturers either directly or through tier 1 suppliers. We work with automotive and heavy duty vehicle manufacturers directly to educate and inform them about the benefits of our technology for use in hybrid electric vehicles, or HEVs, plug-in hybrid electric vehicles, or PHEVs, and electric vehicles, or EVs, and are engaged in design and development efforts with several automotive and heavy duty vehicle manufacturers and tier 1 suppliers. At the same time, we work with tier 1 suppliers who are developing integrated solutions using our batteries. In the electric grid services market, our sales have been initiated directly by our sales force. In the commercial market, our sales are made both directly and indirectly through distributors with key accounts managed by our sales personnel. We have entered into an exclusive agreement to license certain of our technology in the field of commercial electronic devices (excluding power tools and certain other consumer products) and expect to receive royalty fees on net sales of licensed products that include our technology. We expect to continue to expand our sales presence in Europe and Asia as our business in those regions continues to grow. We expect international markets to provide increased opportunities for our products.

Our sales cycles vary by product and market segment. Most of our batteries and battery systems typically undergo a lengthy development and qualification period prior to commercial production. We expect that the total time from customer introduction to commercial production will range up to five years depending on the specific product and market served. Our long and unpredictable sales cycles and the potential large size of battery supply and development contracts cause our period-to-period financial results to be susceptible to significant variability. Since most of our operating and capital expenses are incurred up-front based on the anticipated timing of estimated design wins and customer orders, the loss or delay of any such orders could have a material adverse effect on our results of operations for any particular period. The variability in our period-to-period results will also be driven

Table of Contents

by likely period-to-period variations in product mix and by the seasonality experienced by some of the end markets into which we sell our products. In the electric grid market, revenue recognition is volatile due to the timing of deployment, delivery, and commissioning. As such, the timing of these events will significantly affect the comparison of period-to-period revenues.

We have been expanding our manufacturing capacity since inception, including the current expansion of our Livonia and Romulus, Michigan facilities, and we intend to further expand our manufacturing capacity by constructing more manufacturing lines, primarily in Michigan. We are currently in transition, as we are expanding capacity in anticipation of increased demand for our prismatic cells as we expect transportation product revenues to continue to increase in future periods. We intend to further accelerate the expansion of our manufacturing capacity subject to actual and anticipated future demand for our products and the receipt of additional stimulus funds from the U.S. and state governments. In the first quarter of 2010, we began making investments against plans to further expand the final assembly capacity of our Michigan facilities. We anticipate our annual manufacturing capacity will be approximately 660 million watt hours at the end of 2011, up from approximately 350 million watt hours at the end of 2010. We believe that increases in production capacity have had, and will continue to have, a significant effect on our financial condition and results of operations. We have made and continue to make significant up-front investments in our manufacturing capacity, which negatively impact earnings and cash balances, but we expect these investments will increase our revenue in the long term.

Our research and development efforts are focused on developing new products and improving the performance of existing products. We fund our research and development initiatives both from internal and external sources. As part of our development strategy, certain customers fund or partially fund research and development efforts to design and customize batteries and battery systems for their specific application.

We have continued to experience significant losses since inception, as we have continued to invest significantly to support the anticipated growth in our business. In particular, we have invested in product development and sales and marketing in order to meet product requirements of our target markets and to secure design wins that may lead to strong revenue growth and general and administrative overhead to develop the infrastructure to support the business. We have also invested in the expansion of our manufacturing capacity to meet anticipated demand and our battery systems capabilities to provide battery systems solutions to our customers. As our business grows, the key factors to improving our financial performance will be revenue growth and revenue diversification in the markets in which we participate. Our revenue growth and revenue diversification will depend on our ability to secure design wins in the transportation and electric grid services markets, improved operational efficiency and cost reductions. Higher revenue will also increase gross margin, as higher production volumes will provide for increased absorption of manufacturing overhead and will reduce, on a percentage basis, the costs associated with our production capacity. Further, our revenue growth will allow us to maintain liquidity sufficient to operate our business effectively.

To fund our growth over the next 12 months, including anticipated future losses, purchase commitments, and capital expenditures, we are taking actions to reduce the cash used in operating and investing activities including plans to improve our gross margins, reduce our operating expenses, and increase inventory turns. However, we may also choose to raise additional capital to fund cash requirements through expansion of the existing line of credit and/or additional strategic partnerships. As noted above we have been successful in raising funds and most recently, on November 7, 2011, we announced a series of agreements with IHI Corporation that will provide, among other things, $25.0 million through the sale of common stock and a one-time, non-refundable license fee of $7.5 million for a technology license agreement. We have also been in discussion with other potential strategic partners that could provide additional capital as well as improved access to different markets in which to sell our products.

Table of Contents

Although we are hopeful that we will be able to improve our operating efficiencies and be able to obtain additional financing through new partnerships, there is no guarantee that we will be able to achieve such expected improvements in operating performance or that we will be able to obtain such external funding.

In December 2009, we executed an agreement with the U.S. Department of Energy regarding the terms and conditions of the $249.1 million grant awarded under the DOE's Battery Initiative to fund the construction of new lithium-ion battery manufacturing facilities in Michigan. Under the agreement, the DOE provides cost reimbursement for 50% of qualified expenditures incurred from December 1, 2009 to November 30, 2012 and for reimbursement of pre-award costs incurred from June 1, 2009 to November 30, 2009. Through September 30, 2011, we have received $123.1 million in reimbursement for costs incurred. As of September 30, 2011, we have incurred additional allowable costs entitling us to receive $1.8 million in reimbursements, which have been recorded as a receivable.

In October 2009, we entered into a *High-Tech Credit* agreement with the Michigan Economic Growth Authority, or MEGA, pursuant to which we are eligible for a 15-year tax credit, beginning with payments made for the 2011 fiscal year. This credit has an estimated value of up to $25.3 million, depending on the number of jobs we create in Michigan. In November 2009, we entered into a *Cell Manufacturing Credit* agreement with MEGA pursuant to which we are eligible for a credit equal to 50% of our capital investment expenses commencing January 2009, up to a maximum of $100 million over a four-year period related to the construction of our integrated battery cell manufacturing plant. The tax credit proceeds shall not exceed $25.0 million per year beginning with the tax year of 2012. We are required to create 300 jobs no later than December 31, 2016 in order for the tax credit proceeds to be non-refundable. The tax credit is subject to a repayment provision in the event we relocate 51% or more of the 300 jobs outside of the State of Michigan within three years after the last year we received the tax credit. Through September 30, 2011 we have incurred expenses of $197.0 million in qualified expenses related to the construction of the Livonia and Romulus, Michigan facilities. When we have met the filing requirements for the tax year ending December 31, 2012, we expect to begin receiving $98.5 million in proceeds related to these expenses limited to $25.0 million per year over a four year period. As of September 30, 2011, we have recorded an undiscounted receivable of $98.5 million, as it is reasonably assured that we will comply with the conditions of the tax credit and will receive proceeds. Upon recording the receivable, we reduced the basis in the fixed assets acquired in accordance with the tax credit and this will be recognized in the condensed consolidated statements of operations over their estimated useful lives of the depreciable asset as reduced depreciation expense.

To fund our growth and expansion plans, during April 2011, we raised a total of $253.9 million of net proceeds from the issuance of $143.8 million in principal of convertible unsecured subordinated notes and the issuance of 20.2 million shares of our common stock at $6.00 per share. In September 2011, we entered into a credit agreement providing us with a revolving loan facility in the amount of $40.0 million.

On October 31, 2011, we entered into a Settlement Agreement and related Patent Sublicense Agreement with Hydro-Quebec and the Board of Regents of the University of Texas System, on behalf of the University of Texas at Austin, thereby settling the patent disputes and resolving the existing litigations among the parties. As of September 30, 2011, we accrued for an estimated settlement of $5.0 million related to this lawsuit and is recorded within general and administrative expense in the condensed consolidated statement of operations. We recorded $3.5 million in accrued expenses and the remaining $1.5 million which is expected to be paid in two equal installments in 2013 and 2014 were recorded in other long-term liabilities in the condensed consolidated Balance Sheet. See Note 6 Commitments and Contingencies.

Financial Operations Overview

Revenue

We derive revenue from product sales and providing services.

Product Revenue. Product revenue is derived from the sale of our batteries and battery systems. For the nine months ended September 30, 2010 and 2011, product revenue represented 74% and 88% of our total revenue, respectively.

A significant portion of our revenue is generated from a limited number of customers. For the nine months ended September 30, 2010, our two largest customers during the period accounted for approximately 26% and 16% of our total revenue. During the nine months ended September 30, 2011, our two largest customers during the period accounted for approximately 34% and 17% of our total revenue. We expect that most of our revenue will continue to come from a relatively small number of customers for the foreseeable future. As we increase our focus on the transportation, electric grid and commercial markets, our largest customers are expected to represent a significant portion of our revenue in the near term, and the loss of any one of our largest customers, or the termination of one of our significant supply agreements, could have a material adverse effect on our short-term revenue. We expect the transportation market and the electric grid market to represent the largest portion of our revenue in the near and long term.

Services Revenue. Services revenue is primarily derived from contracts with commercial customers, the U.S. federal government and other government agencies. These activities range from pure research, in which we investigate design techniques on new battery technologies at the request of a government agency or commercial customer, to custom development projects in which we are paid to enhance or modify an existing product or develop a new product to meet a customer's specifications. We expect that revenue from services will vary from period-to-period depending on the amount of costs incurred, the timing of when we are entitled to payments or, if applicable, the achievement of milestones. We expect that services revenue will decrease as a percentage of our total revenue due to the expected increase in product revenue over the long term.

Deferred Revenue. We record deferred revenue for product sales and services in several different circumstances. These circumstances include (i) the products have been delivered or services have been performed but other revenue recognition criteria have not been satisfied, (ii) payments have been received in advance of products being delivered or services being performed and (iii) when all other revenue recognition criteria have been met, but we are not able to reasonably estimate the warranty expense. Deferred revenue includes customer deposits and up-front fees associated with service arrangements. Deferred revenue expected to be recognized as revenue more than one year subsequent to the balance sheet date is classified as long-term deferred revenue. Deferred revenue will vary depending on the timing and amount of cash receipts from customers and can vary significantly depending on specific contractual terms. As a result, deferred revenue is likely to fluctuate from period-to-period. We have received and recorded as deferred revenue a total of $28.0 million related to up-front, support and additional payments in connection with a license agreement. In addition, the agreement requires the customer to pay us royalty fees on net sales of products that include our technology. We have agreed with the customer that if, during a certain period following execution of the license agreement, we enter into an agreement with a third party that materially restricts the customer's license rights under the license agreement, then we may be required to refund to the customer all license and support fees paid to us under the license agreement, plus, in certain cases, an additional amount to cover the customer's capital and other expenses paid and/or committed to in reliance upon its rights under the license agreement. Revenue recognition commenced during the second quarter of 2011 upon successful transfer of technology know how to the customer. The license and support fee will be recognized on a straight-line basis over the longer of the patent term or the expected customer relationship.

Table of Contents

Cost of Revenue and Gross Profit

Cost of product revenue includes the cost of raw materials, labor and components that are required for the production of our products, as well as manufacturing overhead costs (including depreciation), inventory obsolescence charges, and warranty costs. Raw material costs, which are our most significant cost item over the past two years, have historically been stable, but increasing energy costs for some of our materials are expected to increase this cost. This increase may be partially offset by process innovation, dual sourcing of materials and increased volume if we achieve better economies of scale. We incur costs associated with unabsorbed manufacturing expenses prior to a factory operating at normal operating capacity. We expect these unabsorbed manufacturing costs, which include certain personnel, rent, utilities, materials, testing and depreciation costs, to increase in absolute dollars and as a percentage of revenue in the near term.

Cost of services revenue includes the direct labor costs of engineering resources committed to funded service contracts, as well as third-party consulting, and associated direct material and equipment costs. Additionally, we include overhead expenses such as occupancy costs associated with the project resources, engineering tools and supplies and program management expense.

Our gross profit (loss) is affected by a number of factors, including the mix of products sold, customer diversification, the mix between product revenue and services revenue, average selling prices, foreign exchange rates, our actual manufacturing costs and costs associated with increasing production capacity until full production is achieved. As we continue to grow and build out our manufacturing capacity, and as new product designs come into production, our gross profit will continue to fluctuate from period-to-period.

We have expanded our capacity to meet anticipated customer demand, including building out additional manufacturing capacity at our Livonia and Romulus, Michigan facilities. During 2010, we more than doubled our worldwide manufacturing capacity from 169 MWh to approximately 345 MWh. This expansion is part of our plan to support annual manufacturing capacity of 760 MWh. During December 2010, we qualified the first production line at our Livonia facility and qualified the second production line in our Livonia facility in July 2011. We began qualifying our Romulus facility for production during the first half of 2011 which is expected to be qualified in the fourth quarter of 2011. Also, we have put into place manufacturing overhead, including supply chain and quality organizations, which are sized to support significantly higher production volumes than we are currently producing. Increasing our production volume will allow us to reduce per-unit cell costs, improve the absorption of manufacturing overhead costs, and improve our gross margins.

However, though our Michigan facilities are now operational, these facilities are not yet operating at their yield and uptime targets, and we incurred significant additional expenditures, such as premium freight, required to launch these facilities on a compressed timeline. As production volumes increase, equipment performance improves, our supply base matures and design changes are incorporated into our cells, we anticipate a steady improvement in our margins in the near term.

Our long-term financial objective is to achieve and support sustained profitable growth. To meet this objective, we are currently focusing on completing the expansion of our manufacturing capacity and increasing production volumes to achieve lower material costs due to volume purchase discounts and improved absorption of our manufacturing overhead costs, thereby reducing per-unit production cost.

Operating Expenses

Operating expenses consist of research, development and engineering, sales and marketing, general and administrative and production start-up expenses. Personnel-related expenses comprise the most significant component of these expenses. We hired a significant number of new employees in order to support our growth and increase our infrastructure. In any particular period, the timing of additional hires could materially affect our operating expenses, both in absolute dollars and as a percentage of revenue. During the third quarter of 2010, we opened our manufacturing facility in Livonia, Michigan, and the first production line our Livonia facility was qualified for production in December 2010 while the second production line in our Livonia facility was qualified in July 2011. The Romulus facility began qualification for production in the first quarter of 2011 and is expected to be qualified in the fourth quarter of 2011. We expect to continue to incur production start-up expenses related to the Romulus facility until the facility is qualified.

Research, Development and Engineering Expenses. Research, development and engineering expenses consist primarily of expenses for personnel engaged in the development of new products and the enhancement of existing products, as well as lab materials, quality assurance activities and facilities costs and other related overhead. These expenses also include pre-production costs related to long-term supply agreements unless reimbursement from the customer is contractually guaranteed. Pre-production costs consist of engineering, design and development costs for products sold under long-term supply arrangements. We expense all of our research, development and engineering costs as they are incurred. In the near term, we expect research, development and engineering expenses to increase in large part due to personnel-related expenses, as well as contract-related expenses as we continue to invest in the development of our products. Accordingly, we expect that our research, development and engineering expenses will continue to increase in absolute dollars but decrease as a percentage of revenue in the long term. Research, development and engineering expense is reported net of any funding received under contracts with governmental agencies and commercial customers that are considered to be cost sharing arrangements with no contractually committed deliverable.

Sales and Marketing Expenses. Sales and marketing expenses consist primarily of personnel-related expenses, travel and other out-of-pocket expenses for marketing programs, such as trade shows, industry conferences, marketing materials and corporate communications, facilities costs and other related overhead. We intend to hire additional sales personnel, initiate additional marketing programs and build additional relationships with resellers, systems integrators and strategic partners on a global basis. Accordingly, we expect that our sales and marketing expenses will continue to increase in absolute dollars but decrease as a percentage of revenue in the long term.

General and Administrative Expenses. General and administrative expenses consist primarily of personnel-related expenses related to our executive, legal, finance, human resource and information technology functions, as well as fees for professional services and allocated facility overhead expenses. Professional services consist principally of external legal, accounting, tax, audit and other consulting services. We expect to continue to incur general and administrative expenses related to operating as a publicly-traded company, including increased audit and legal fees, costs of compliance with securities, corporate governance and other regulations, investor relations expenses and higher insurance premiums, particularly those related to director and officer insurance. In addition, we expect to incur additional costs as we hire personnel and enhance our infrastructure to support the anticipated growth of our business. Accordingly, we expect that our general and administrative expenses will continue to increase in absolute dollars but decrease as a percentage of revenue in the long term.

Production Start-up Expenses. Production start-up expenses consist of salaries and personnel-related costs, site selection costs, including legal and regulatory costs, rent and the cost of operating a production line before it is qualified for production, including the cost of raw materials, and the related labor and overhead, run through the production line during the qualification phase. We expect to incur additional production start-up expenses in the near term related to our facility in Romulus, Michigan. The Livonia facility began qualification for production in the third quarter of 2010 and the first production line was qualified in December 2010 while the second production line was qualified in July 2011. The Romulus facility began qualification for production in the first quarter of 2011 and is expected to be qualified in the fourth quarter of 2011.

Table of Contents

Other Income (Expense), Net. Other income (expense), net consists primarily of interest income on cash balances, interest expense on borrowings, foreign currency-related gains and losses, equity-method earnings and other gains or losses. We have historically invested our cash in money market investments. Our interest income will vary each reporting period depending on our average cash balances during the period and the current level of interest rates. Similarly, our foreign currency-related gains and losses will also vary depending upon movements in underlying exchange rates. Other income includes equity losses related to our proportional share of earnings in investments accounted for under the equity method and will vary each reporting period depending on the earnings or losses of these entities and gains or losses on long-term investments will vary each reporting period depending on the timing of any joint ventures or other equity investments we may enter into, the investment made by us, and the ongoing operations of the investee. Additionally, for the nine months ended September 30, 2011, other income includes the gain recognized on the deconsolidation of our joint venture previously consolidated as a variable interest entity.

Provision for Income Taxes. Through September 30, 2011, we incurred net losses since inception and have not recorded provisions for U.S. federal income taxes since the tax benefits of our net losses have been offset by valuation allowances.

We have recorded a tax provision for foreign taxes associated with our foreign subsidiaries and state income taxes where our net operating loss deductions are limited by statutes.

Watt Hours Operating Metric

We measure our product shipments in watt hours, or Wh, which refers to the aggregate amount of energy that could be delivered in a single complete discharge by a battery. We calculate Wh for each of our battery models by multiplying the battery's amp hour, or Ah, storage capacity by the battery's voltage rating. For example, our 26650 battery is a 2.3 Ah battery that operates at 3.3 Volt, resulting in a 7.6 Wh rating. We determine a battery's Ah storage capacity at a specific discharge rate and a specific depth of discharge. We do this by charging the battery to its top voltage and by discharging it to zero capacity (2 volt charge level). The Wh metric allows us and our investors to measure our manufacturing capacity and shipments, regardless of battery voltages and Ah specifications, utilizing a uniform and consistent metric.

Certain Trends and Uncertainties

The following represents a summary of certain trends and uncertainties, which could have a significant impact on our financial condition and results of operations. This summary is not intended to be a complete list of potential trends and uncertainties that could impact our business in the long or short term. The summary, however, should be considered along with the factors identified in the section titled "*Risk Factors*" set forth in Part II, Item 1A of this Quarterly Report on Form 10-Q.

- We anticipate revenue for the full year 2011 will grow 70% to 85% from 2010 revenue, primarily related to one of our significant customers transitioning into production during 2011. Further, we anticipate the number of transportation programs in production to at least double over the next two years. However, for the foreseeable future, we expect a significant portion of our revenues will continue to come from a relatively small number of customers. The loss of one of our most significant customers, several of our smaller customers, or one of our existing supply agreements for significant future revenues, could materially harm our business.

- We anticipate the volume of our product shipments will increase substantially, based on stated demand from existing customers, which in turn, will lead to improving gross margins. We expect gradual improvement toward positive gross margin levels over the next several quarters as we continue to improve our manufacturing operational effectiveness and reduce costs through higher factory utilization, yield improvements and an improved materials supply base.

Table of Contents

- We anticipate that our annual manufacturing capacity will be 660 million watt hours at the end of 2011, compared to 350 million watt hours at the end of 2010. We build our manufacturing capacity based on estimated demand from existing supply agreements, from our projection of future development and supply agreement wins and from anticipated timelines of customer orders. Increases in production capacity have had, and will continue to have, an effect on our financial condition and results of operations. Our business revenues, profits and gross margins depend upon our ability to enter into and complete development and supply agreements, successfully complete these capacity expansion projects, achieve competitive manufacturing yields and drive volume sales consistent with our demand expectations.

- We believe that our future revenues depend on our ability to develop, manufacture and market products that improve upon existing battery technology and gain market acceptance. If our battery technology is not adopted by our customers, or if our battery technology does not meet industry requirements for power and energy storage capacity in an efficient and safe design, our batteries will not gain market acceptance.

- Extended periods of low natural gas prices in the U.S. could adversely affect demand for certain applications in our electric grid services business in the U.S. market.

Critical Accounting Policies

Our condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of our condensed consolidated financial statements and related disclosures requires us to make estimates, assumptions and judgments that affect the reported amount of assets, liabilities, revenue, costs and expenses, and related disclosures. We base our estimates and assumptions on historical experience and other factors that we believe to be reasonable under the circumstances. We evaluate our estimates and assumptions on an ongoing basis. Our actual results may differ from these estimates under different assumptions and conditions. Our most critical accounting policies are listed below.

- Revenue recognition;

- Product warranty obligations;

- Inventory;

- Impairment of long-lived assets;

- Government grants; and

- Investments in non-public companies.

During the nine months ended September 30, 2011, there were no significant changes in our critical accounting policies or estimates, with the exception of the expansion of our policies regarding impairment of long-lived assets and government grants which are disclosed below.

Long-lived Assets

We periodically evaluate our long-lived assets for events and circumstances that indicate a potential impairment. We review long-lived assets for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable or that the useful lives of these assets are no longer appropriate. Such circumstances would include, but are not limited to, material adverse changes in projected revenues and expenses, significant underperformance relative to historical or projected future operating results and significant negative industry or economic trends. Each impairment test is based on a comparison of the estimated undiscounted cash flows of the asset or asset group over the remaining life of the asset as compared to the recorded value of the asset.

33

Table of Contents

To the extent the carrying value exceeds the fair value of the asset or asset group, an impairment loss is recognized in the statement of operations in that period.

The estimates used to determine whether impairment has occurred are subject to a number of management assumptions. We group long-lived asset or assets with other assets and liabilities as the lowest level for which identifiable cash flows are available. We estimate the fair value of an asset or asset group based on market prices (i.e., the amount for which the asset could be bought by or sold to a third party), when available. When market prices are not available, we estimate the fair value of the asset group using the income approach, which are subject to a number of management assumptions. The income approach uses cash flow projections. Inherent in our development of cash flow projections are assumptions and estimates derived from a review of our operating results, approved operating budgets, expected growth rates and cost of capital. We also make certain assumptions about future economic conditions, interest rates, and other market data. Many of the factors used in assessing fair value are outside the control of management, and these assumptions and estimates can change in future periods.

Changes in assumptions or estimates could materially affect the determination of fair value of an asset group, and therefore could affect the amount of potential impairment of the asset. We make assumptions about our product production, service sales, cost of products and services and estimated residual value of property, plant and equipment. These assumptions are key inputs for developing our cash flow projections. These projections are derived using our internal operating budgets. These projections are updated annually and reviewed by the Board of Directors. Historically, the primary variances between our projections and actual results have been with regard to assumptions for future production, service sales, and cost of products and services. These factors are based on our best knowledge at the time we prepare our budgets but can vary significantly due to changes in supply and demand, changes in raw material prices, and changes in other economic conditions.

During the nine months ended September 30, 2011, we recorded an impairment charge of $2.6 million related to long-lived assets at our China and Korea facilities.

Government Grants

We recognize government grants when there is a reasonable assurance that we will comply with the conditions attached to the grant arrangement and the grant will be received. We evaluate the conditions of each individual grant as of each reporting period to ensure that we have reached reasonable assurance of meeting the conditions of each grant arrangement and that it is expected that the grant will be received as a result of meeting the necessary conditions. For example, if a grant has conditions where we must create and maintain a certain number of jobs, we will record the grant in the period that we have evaluated and determined that the necessary number of jobs has been created and, based on our forecasts, we are reasonably assured that the jobs will be maintained during the required employment period. For reimbursements of expenses, the government grants are recognized as reduction of the related expense. For reimbursements of capital expenditures, the grants are recognized as a reduction of the basis of the asset. The grant is recognized in profit or loss over the life of a depreciable asset as reduced depreciation expense. We record government grant receivables in current or long-term assets depending on when the amounts are expected to be received from the government agency. We do not discount long-term grant receivables. When funding is received in advance of complying with certain conditions, we recognize a liability and restricted cash on the consolidated balance sheets until such time as the funding has been spent.

See our Annual Report on Form 10-K for the year ended December 31, 2010, filed with the SEC on March 11, 2011, for additional information about our critical accounting policies, as well as a description of our other significant accounting policies.

Table of Contents

Results of Consolidated Operations

The following table sets forth the results of our operations as a percentage of revenue for each of the following periods (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2011	2010	2011
Revenue	100%	100%	100%	100%
Cost of revenue	112%	130%	111%	144%
Gross loss	(12)%	(30)%	(11)%	(44)%
Operating expenses	157%	64%	133%	97%
Operating loss	(169)%	(94)%	(144)%	(141)%
Other income (expense), net	2%	(4)%	(1)%	(4)%
Loss from operations, before tax	(166)%	(98)%	(146)%	(145)%
Provision for income taxes	0%	1%	1%	1%
Net loss	(167)%	(99)%	(146)%	(145)%
Other Operating Data:				
Shipments (in watt hours, or Wh) (in thousands)	15,779	67,723	44,224	124,617

Three Months Ended September 30, 2010 and 2011

Revenue

	Three Months Ended September 30,			
	2010	2011	$ Change	% Change
	(Dollars in thousands)			
Revenue				
Product				
Transportation	$ 9,532	$ 34,450	$ 24,918	261.4%
Commercial	3,460	4,612	1,152	33.3%
Electric grid	5,973	20,541	14,568	243.9%
Total product	18,965	59,603	40,638	214.3%
Services	7,253	4,716	(2,537)	(35.0)%
Total revenue	$ 26,218	$ 64,319	$ 38,101	145.3%

Product Revenue. The increase in sales in the transportation industry of $24.9 million for the three months ended September 30, 2011 compared to the three months ended September 30, 2010 was primarily due to the transition of one of our customers to volume production and our delivery against the supply agreement with this customer. In addition, the transition of several of our other customers from development programs to prototype production programs corresponded to an increase in sales to these customers for the three months ended September 30, 2011 as compared to the three months ended September 30, 2010. These increases were partially offset by a decrease of $1.1 million in sales to one of our existing production stage transportation customers. We expect sales to this customer to continue to decrease as a percentage of transportation revenue as revenues from other customers

increase. Sales in the commercial industry increased by $1.1 million for the three months ended September 30, 2011 compared to the three months ended September 30, 2010 primarily due to variations in demand from existing customers. Sales to customers in the electric grid industry increased by $14.6 million for the three months ended September 30, 2011 compared to the three months ended September 30, 2010 related to the installation and commissioning of energy storage units. Most of our electric grid products involve project-based contracts with multiple elements in which there are separate units of accounting within the arrangement. The timing of when we complete the required deliverables for the units of accounting and when all other revenue recognition criteria are met, may cause some variability in timing of revenue recognition. We anticipate that revenue recognition in the electric grid market for future periods will continue to be volatile due to the timing of deployment, delivery and commissioning of systems.

Services Revenue. The decrease in services revenue of $2.5 million was primarily related to the timing of project milestones and project completion on active projects. Of the $2.5 million decrease, $2.0 million was due to a certain transportation customer program transitioning from the development stage, where we recognized service revenue, to a production program where we recognize product revenue on a seasonal basis specifically with this customer. Services revenue from a certain government agency also decreased by $1.9 million due to project completion. These decreases were partially offset by a $1.4 million increase in services revenue.

Cost of Revenue and Gross Profit (Loss)

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2011	$ Change	% Change
	(Dollars in thousands)			
Cost of revenue				
Product	$ 23,755	$ 78,014	$ 54,259	228.4%
Services	5,538	5,878	340	6.1%
Total cost of revenue	$ 29,293	$ 83,892	$ 54,599	186.4%
Gross profit (loss)				
Product	$ (4,790)	$ (18,411)	$ (13,621)	284.4%
Services	1,715	(1,162)	(2,877)	(167.8)%
Total gross profit (loss)	$ (3,075)	$ (19,573)	$ (16,498)	536.5%

Cost of Product Revenue. The increase in cost of product revenue of $54.3 million was primarily due to the increase in product revenues and a change in the mix of products sold in the three months ended September 30, 2011 as compared to the three months ended September 30, 2010. The three months ended September 30, 2011 included a higher ratio of prismatic cell products shipped of 20% compared to 4% in the three months ended September 30, 2010. As we are in the process of qualification and production ramp-up at our Livonia and Romulus, Michigan facilities, our prismatic cell costs are currently higher as these facilities are not yet operating at their yield and uptime targets and we have incurred significant extra expenses, a portion of which are included in production start-up expenses, to launch these facilities on a compressed timeline.

We are currently incurring higher part costs as we purchase certain parts at low volumes. As our production volumes of prismatic have increased, our material costs have begun to decrease as we benefit from volume purchase discounts. We expect this trend to continue. Due to low factory utilization, unabsorbed manufacturing expenses were $5.0 million for the three months ended September 30, 2010, compared to $10.5 million for the three months ended September 30, 2011. The increase in unabsorbed manufacturing expenses was primarily due to the increase in capacity brought online in Michigan late in 2010. As production volumes increase and our manufacturing process matures, we anticipate reduced per-unit costs through improved absorption of manufacturing overhead, improved labor efficiencies, reduced scrap charges and other process improvements.

Cost of Services Revenues. The increase in costs of services revenue for the three months ended September 30, 2011 as compared to the three months ended September 30, 2010 is due to the timing of project based costs.

Product Gross Profit (Loss). We experienced a product gross loss during the three months ended September 30, 2011, primarily due to low factory utilization and a change in the mix of products sold in the three months ended September 30, 2011. The three months ended September 30, 2011 included a higher ratio of prismatic cell products. Currently, our prismatic cell products have higher per-unit costs than we anticipate in the future as we are in the process of qualification and production ramp-up at our Livonia and Romulus facilities, as discussed above, and currently have lower gross margins as compared to cylindrical cell products which are a more mature product line.

Our future gross profit will be affected by numerous factors, including the build-out of our manufacturing capacity, the timing of the production of new product designs and our ability to reduce cell costs. While we complete the expansion of our manufacturing capacity and ramp-up production volume of prismatic cells, our gross loss will be negatively affected by higher per-unit costs. When we increase our production volumes we anticipate lower per-unit costs due to lower material costs, improved absorption of our manufacturing overhead costs, and improved efficiencies that will all drive down the per-unit cell costs, and positively impact our gross profit. Unabsorbed manufacturing expenses were $10.5 million during the three months ended September 30, 2011. Due to unabsorbed manufacturing costs and the timing of project-based revenues and costs, we anticipate our gross profit or loss will vary significantly from period-to period going forward.

Services Gross Profit. Services gross profit decreased in the three months ended September 30, 2011 as compared to the three months ended September 30, 2010 due to the timing of project milestones and the mix of current contracts. We recognize services project costs as incurred and, for programs which include milestones, we recognize services revenue upon the completion of project milestones when collectability is reasonably assured. As such, our services gross profit will fluctuate period over period based on the timing of milestones.

Operating Expenses

	Three Months Ended September 30,			
	2010	**2011**	**$ Change**	**% Change**
		(Dollars in thousands)		
Operating expenses				
Research, development and engineering	$ 16,019	$ 19,181	$ 3,162	19.7%
Sales and marketing	3,506	4,515	1,009	28.8%
General and administrative	9,860	16,289	6,429	65.2%
Production start-up	11,751	1,097	(10,654)	(90.7)%
Total operating expenses	$ 41,136	$ 41,082	$ (54)	(0.1)%

Table of Contents

Research, Development and Engineering Expenses. A portion of research, development and engineering expenses was offset by cost-sharing funding. Our research, development and engineering expenditures are summarized as follows:

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2011	$ Change	% Change
	(Dollars in thousands)			
Research, development and engineering expenses				
Aggregated research, development and engineering expenditures	$ 17,763	$ 22,074	$ 4,311	24.3%
Research, development and engineering reimbursements	(1,744)	(2,893)	(1,149)	65.9%
Research, development and engineering expenses	$ 16,019	$ 19,181	$ 3,162	19.7%

The increase in research, development and engineering expenses for the three months ended September 30, 2011 compared to the three months ended September 30, 2010 was primarily attributable to an increase of $2.3 million in expenses associated with an increase in personnel and $1.7 million increase in services from consultants. These additional employees and consultants primarily focus on process improvement, material science chemistry and battery and battery systems technology that support the increase in customer product development programs. This increase was partially offset by a decrease of $0.8 million in the three months ended September 30, 2011 related to other research, development and engineering cost. Research, development and engineering expense was 61% of revenue for the three months ended September 30, 2010, compared to 30% for the three months ended September 30, 2011.

Sales and Marketing Expenses. The increase in sales and marketing expenses for the three months ended September 30, 2011 compared to the three months ended September 30, 2010 was primarily attributable to an increase of $1.4 million in personnel-related expenses associated with an increase in sales and marketing personnel. This increase was partially offset by a decrease of $0.4 million in the three months ended September 30, 2011 resulting from a decrease in marketing expenses related to trade shows, public relations, advertising, and other sales and marketing related expenses. Sales and marketing expense was 13% of revenue for the three months ended September 30, 2010, compared to 7% for the three months ended September 30, 2011.

General and Administrative Expenses. The increase in general and administrative expenses for the three months ended September 30, 2011 compared to the three months ended September 30, 2010 was primarily due to an increase of $5.0 million as a result of the litigation settlement related to the Hydro-Quebec, an increase of $1.0 million related to utilities and facilities expenses and an increase in other general and administrative expenses of $0.4 million. General and administrative expense was 38% of revenue for the three months ended September 30, 2010, compared to 25% for the three months ended September 30, 2011.

Production start-up. A portion of production start-up expenses was offset primarily by government grant funding. Our production start-up expenditures are summarized as follows:

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2011	$ Change	% Change
	(Dollars in thousands)			
Production start-up expenditures				
Aggregated production start-up expenditures	$ 15,603	$ 1,851	$ (13,752)	(88.1)%
Production start-up reimbursements	(3,852)	(754)	3,098	(80.4)%
Production start-up expenses	$ 11,751	$ 1,097	$ (10,654)	(90.7)%

The decrease in production start-up expenses for the three months ended September 30, 2011 compared to the three months ended September 30, 2010 was primarily due to decreased production start-up expenses related to our manufacturing expansion at our Livonia, Michigan facility as the first production line was qualified for production in December 2010. This decrease was partially offset by increased production start-up expenses related to our manufacturing expansion for our coating plant at our Romulus, Michigan facility which began qualification in the first quarter of 2011. Additionally, for the three months ended September 30, 2011 compared to the three months ended September 30, 2010, cost offsets from government grant funding decreased by $3.1 million. Production start-up expenses were 45% of revenue for the three months ended September 30, 2010, compared to 2% for the three months ended September 30, 2011.

Other Income (Expense), Net

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2011	$ Change	% Change
	(Dollars in thousands)			
Other income (expense), net				
Interest expense, net	$ (199)	$ (2,227)	$ (2,028)	1019.1%
Gain (loss) on foreign exchange	713	(98)	(811)	(113.7)%
Other (expense) income, net	87	(143)	(230)	(264)%
Total other expense, net	$ 601	$ (2,468)	$ (3,069)	(510.6)%

The change in interest, net for the three months ended September 30, 2011 was primarily due to an increase in interest expense on the Convertible Notes and capital lease obligations during the three months ended September 30, 2011. The decrease in net foreign exchange losses for the three months ended September 30, 2011, compared to the three months ended September 30, 2010, is due to the effect of currency exchange rate changes on transactions that are non U.S. dollar denominated and charged or credited to earnings. Other income is due to losses recognized on our Chinese joint venture accounted for under the equity method.

Provision for Income Taxes. The provision for income taxes for the three months ended September 30, 2010 and 2011 was primarily related to foreign and state income taxes. We did not report a benefit for federal income taxes in the condensed consolidated financial statements as the deferred tax asset generated from our net operating loss has been offset by a full valuation allowance because it is more likely than not that the tax benefits of the net operating loss carry forward may not be realized.

Table of Contents

Nine Months Ended September 30, 2010 and 2011

Revenue

	Nine Months Ended September 30,			
	2010	2011	$ Change	% Change
	(Dollars in thousands)			
Revenue				
Product				
Transportation	$ 30,239	$ 71,152	$ 40,913	135.3%
Commercial	12,829	12,922	93	0.7%
Electric grid	11,229	20,551	9,322	83.0%
Total Product	54,297	104,625	50,328	92.7%
Services	18,997	14,144	(4,853)	(25.5)%
Total revenue	$ 73,294	$ 118,769	$ 45,475	62.0%

Product Revenue. The increase in sales in the transportation industry of $40.9 million for the nine months ended September 30, 2011 compared to the nine months ended September 30, 2010 was primarily due to the transition of one of our customers to volume production and our delivery against the supply agreement with this customer. Additionally, the transition of several of our other customers from development programs to prototype production programs, corresponded to an increase in sales to these customers for the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010. These increases were partially offset by a decrease of $11.0 million in sales to one of our existing production stage transportation customers. We expect sales to this customer to decrease as a percentage of transportation revenue as revenues from other customers increase. The sales in the commercial industry for the nine months ended September 30, 2011 compared to the nine months ended September 30, 2010 were consistent with last year.

The increase in sales in the electric grid industry of $9.3 million for the nine months ended September 30, 2011 compared to the nine months ended September 30, 2010 is driven by the timing of demand from our existing production customers. Most of our electric grid products involve project-based contracts with multiple elements in which there are separate units of accounting within the arrangement. The timing of when we complete the required deliverables for the units of accounting and when all other revenue recognition criteria are met, may cause some variability in timing of revenue recognition. We anticipate that revenue recognition in the electric grid market for future periods will continue to be volatile due to the timing of deployment, delivery and commissioning of systems.

Services Revenue. The decrease in services revenue of $4.9 million was primarily due to a decrease of $7.0 million related to a contract with a government agency where a substantial amount of the development work was completed in the nine months ended September 30, 2010. This decrease was offset by a $2.1 million increase in other services revenue resulting from the timing of project milestones and project completions, on active projects. For programs which include milestones, we recognize services revenue upon the completion of project milestones when collectability is reasonably assured.

Table of Contents

Cost of Revenue and Gross Profit (Loss)

	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2011	$ Change	% Change
	(Dollars in thousands)			
Cost of revenue				
Product	$ 65,086	$ 157,928	$ 92,842	142.6%
Services	16,273	13,422	(2,851)	(17.5)%
Total cost of revenue	$ 81,359	$ 171,350	$ 89,991	110.6%
Gross profit (loss)				
Product	$ (10,789)	$ (53,303)	$ (42,514)	394.0%
Services	2,724	722	(2,002)	(73.5)%
Total gross loss	$ (8,065)	$ (52,581)	$ (44,516)	552.0%

Cost of Product Revenue. The increase in cost of product revenue was primarily due to an increase in product revenues and a change in the mix of products sold in the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010. The nine months ended September 30, 2011 included a higher ratio of prismatic cell products shipped of 22% compared to 3% in the nine month ended September 30, 2010. As we are in the process of qualification and production ramp-up at our Livonia and Romulus, Michigan facilities, our prismatic cell costs are currently higher as these facilities are not yet operating at their yield and uptime targets and we have incurred significant extra expenses, a portion of which are included in production start-up expenses, to launch these facilities on a compressed timeline.

Additionally, we are currently incurring higher part costs as we purchase certain parts at low volumes. As our production volumes of prismatic have increased, our material costs have begun to decrease as we benefit from volume purchase discounts. Due to low factory utilization, unabsorbed manufacturing expenses were $14.7 million for the nine months ended September 30, 2010, compared to $24.2 million for the nine months ended September 30, 2011. The increase in unabsorbed manufacturing expenses was due to the increase in capacity brought online in Michigan late in 2010 combined with the fact that production volumes for customer agreements did not begin to increase until the second quarter of 2011. As production volumes increase and our manufacturing process matures, we anticipate reduced per-unit costs through improved absorption of manufacturing overhead, improved labor efficiencies, reduced scrap charges and other process improvements.

Cost of Services Revenues. The decrease in costs of services revenue resulted from the decrease in services revenues in addition to the mix of contracts for the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010. The nine months ended September 30, 2010 included higher cost of services revenue due to the timing of project based costs.

Product Gross Profit (Loss). We experienced a product gross loss during the nine months ended September 30, 2011, primarily due to low factory utilization and a change in the mix of products sold in the nine months ended September 30, 2011 as the nine months ended September 30, 2011 included a higher ratio of prismatic cells. Currently, our prismatic cell products have higher per-unit costs we anticipate in the future as we are in the process of qualification and production ramp-up at our Livonia and Romulus, Michigan facilities, as discussed above, and correspondingly, have lower gross margins as compared to cylindrical cell products which are a more mature product line.

Our future gross profit will be affected by numerous factors, including the build-out of our manufacturing capacity, the timing of the production of new product designs and our ability to reduce cell costs. While we complete the expansion of our manufacturing capacity and ramp-up production volume of prismatic cells, our gross loss will be negatively affected by higher per-unit costs. When we increase our production volumes we anticipate lower per-unit costs due to lower material costs, improved absorption of our manufacturing overhead costs, and improved efficiencies that will all drive down the per-unit cell costs, and positively impact our gross profit. Unabsorbed manufacturing expenses were $24.2 million during the nine months ended September 30, 2011 as compared to $14.7 million for the nine months ended September 30, 2010 due to increased capacity brought online in Michigan in late 2010. Due to unabsorbed manufacturing costs and the timing of project-based revenues and costs, we anticipate our gross profit or loss will vary significantly from period-to period going forward.

Services Gross Profit. Services gross profit decreased in the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010 due to the increases in project costs, the timing of project milestones and the mix of current contracts. We recognize services project costs as incurred and, for programs which include milestones, we recognize services revenue upon the completion of project milestones when collectability is reasonably assured. As such, our services gross profit will fluctuate period over period based on the timing of milestones.

Operating Expenses

	Nine Months Ended September 30,			
	2010	**2011**	**$ Change**	**% Change**
		(Dollars in thousands)		
Operating expenses				
Research, development and engineering	$ 43,967	$ 56,974	$ 13,007	29.6%
Sales and marketing	9,672	13,667	3,995	41.3%
General and administrative	26,904	34,799	7,895	29.3%
Production start-up	17,168	9,215	(7,953)	(46.3)%
Total operating expenses	$ 97,711	$ 114,655	$ 16,944	17.3%

Research, Development and Engineering Expenses. A portion of research, development and engineering expenses was offset by cost-sharing funding. Our research, development and engineering expenditures are summarized as follows:

	Nine Months Ended September 30,			
	2010	**2011**	**$ Change**	**% Change**
		(Dollars in thousands)		
Research, development and engineering expenses				
Aggregated research, development and engineering expenditures	$ 47,686	$ 62,015	$ 14,329	30.0%
Research, development and engineering reimbursements	(3,719)	(5,041)	(1,322)	35.5%
Research, development and engineering expenses	$ 43,967	$ 56,974	$ 13,007	29.6%

The increase in research, development and engineering expenses for the nine months ended September 30, 2011 compared to the nine months ended September 30, 2010 was primarily attributable to an increase of $10.8 million in expenses associated with an increase in personnel who primarily focus on process improvement, material science chemistry and battery and battery systems technology and who support the increase in customer product development programs as we continue to perform research to develop new products and continuously improve the performance of our existing products. Also, other research, development and engineering cost increased by $2.2 million in the nine months ended September 30, 2011. Research, development and engineering expense was 60% of revenue for the nine months ended September 30, 2010, compared to 48% for the nine months ended September 30, 2011.

Sales and Marketing Expenses. The increase in sales and marketing expenses for the nine months ended September 30, 2011 compared to the nine months ended September 30, 2010 was primarily attributable to an increase of $4.9 million in expenses associated with an increase in sales and marketing personnel. This increase was partially offset by a decrease of $0.9 million in the nine months ended September 30, 2011 related to marketing expenses related to trade shows, public relations, advertising, and other sales and marketing related expenses. Sales and marketing expense was 13% of revenue for the nine months ended September 30, 2010, compared to 12% for the nine months ended September 30, 2011.

General and Administrative Expenses. The increase in general and administrative expenses for the nine months ended September 30, 2011 compared to the nine months ended September 30, 2010 was primarily due to an increase of $5.0 million in litigation related expenses as a result of the litigation settlement related to Hydro-Quebec. Additionally, personnel-related expenses increased by $2.0 million, associated with an increase in general and administrative personnel and an increase in depreciation expenses of $2.0 million and utilities expenses of $1.6 million resulting from the expansion of our corporate facilities in the nine months ended September 30, 2011. These increases were partially offset by a decrease in accounting and legal fees of $1.3 million and other general and administrative expenses of $1.4 million. General and administrative expense was 37% of revenue for the nine months ended September 30, 2010, compared to 29% for the nine months ended September 30, 2011.

Production start-up. A portion of production start-up expenses was offset primarily by government grant funding. Our production start-up expenditures are summarized as follows:

	Nine Months Ended September 30,			
	2010	**2011**	**$ Change**	**% Change**
	(Dollars in thousands)			
Production start-up expenditures				
Aggregated production start-up expenditures	$ 22,490	$ 13,792	$ (8,698)	(38.7)%
Production start-up reimbursements	(5,322)	(4,577)	745	(14.0)%
Production start-up expenses	$ 17,168	$ 9,215	$ (7,953)	(46.3)%

The decrease in production start-up expenses for the nine months ended September 30, 2011 compared to the nine months ended September 30, 2010 was primarily due to decreased production start-up expenses related to our manufacturing expansion at our Livonia, Michigan facility as the first production line was qualified for production in December 2010. This decrease was partially offset by a decrease in cost offsets from government grant funding totaling $0.7 million. Production start-up expenses were 23% of revenue for the nine months ended September 30, 2010, compared to 8% for the nine months ended September 30, 2011.

Table of Contents

Other Income (Expense), Net

	Nine Months Ended September 30,			
	2010	2011	$ Change	% Change
	(Dollars in thousands)			
Other income (expense), net				
Interest expense, net	$ (789)	$ (4,973)	$ (4,184)	530.3%
Gain (loss) on foreign exchange	(268)	(19)	249	(92.9)%
Other (expense) income, net	87	530	443	509.2%
Total other expense, net	$ (970)	$ (4,462)	$ (3,492)	360.0%

The change in interest, net for the nine months ended September 30, 2011 was due to an increase in interest expense due to interest accrued on the Convertible Notes and interest on capital lease obligations outstanding during the nine months ended September 30, 2011. The decrease in net foreign exchange gains for the nine months ended September 30, 2011, compared to the nine months ended September 30, 2010, is due to the effect of currency exchange rate changes on transactions that are non U.S. dollar denominated and charged or credited to earnings. Other income is primarily due to a gain of $1.2 million recognized on the deconsolidation of our joint venture which was previously consolidated as a variable interest entity. This gain is partially offset by losses recognized on our Chinese joint venture and losses recognized on our investment in 24M Technologies, Inc., a privately-held company, both accounted for under the equity method.

Provision for Income Taxes. The provision for income taxes for the nine months ended September 30, 2010 and 2011 was primarily related to foreign and state income taxes. We did not report a benefit for federal income taxes in the condensed consolidated financial statements as the deferred tax asset generated from our net operating loss has been offset by a full valuation allowance because it is more likely than not that the tax benefits of the net operating loss carry forward may not be realized.

Liquidity and Capital Resources

Sources of Liquidity

The following table sets forth the major sources and uses of cash for each of the periods set forth below (in thousands):

	Nine Months Ended September 30,	
	2010	2011
Net cash used in operating activities	$ (86,417)	$ (197,978)
Net cash used in investing activities	(74,649)	(74,459)
Net cash provided by financing activities	4,621	281,431
Effect of foreign exchange rates on cash and cash equivalents	156	(17)
Net (decrease) increase in cash and cash equivalents	$ (156,289)	$ 8,977

Since inception, we have funded our operations primarily through private placements of preferred stock, common stock, convertible promissory notes, demand notes, term loans, credit facilities and our initial public offering. During the nine months ended September 30, 2011, we received net proceeds, after deducting issuance costs, of $138.8 million, $115.2 million and $38.1 million from the issuance of convertible notes, the issuance of common stock and a revolving line of credit, respectively.

Additionally, we received proceeds from government grants of $32.0 million as reimbursement of capital expenditures. As of September 30, 2011, we had cash and cash equivalents of $225.8 million and accounts receivable of $59.4 million.

To fund our growth over the next 12 months, including anticipated future losses, purchase commitments, and capital expenditures, we are taking actions to reduce the cash used in operating and investing activities including plans to improve our gross margins, reduce our operating expenses, and increase inventory turns. However, we may also choose to raise additional capital to fund cash requirements through expansion of the existing line of credit and/or additional strategic partnerships. As noted above we have been successful in raising funds and most recently, on November 7, 2011, we announced a series of agreements with IHI Corporation that will provide, among other things, $25 million through the sale of common stock and a one-time, non-refundable license fee of $7.5 million for a technology license agreement. We have also been in discussion with other potential strategic partners that could provide additional capital as well as improved access to different markets in which to sell our products. Although we are hopeful that we will be able to improve our operating efficiencies and be able to obtain additional financing through new partnerships, there is no guarantee that we will be able to achieve such expected improvements in operating performance or that we will be able to obtain such external funding.

Cash Flows From Operating Activities

Operating activities used $198.0 million of net cash during the nine months ended September 30, 2011. We incurred a net loss of $172.8 million in the nine months ended September 30, 2011, which included non-cash share-based compensation expense of $10.4 million and depreciation and amortization of $18.2 million. Investments in working capital and other changes in asset and liability accounts used $57.8 million of net cash during the nine months ended September 30, 2011.

Operating activities used $86.4 million of net cash during the nine months ended September 30, 2010. We incurred a net loss of $107.1 million in the nine months ended September 30, 2010, which included non-cash share-based compensation expense of $8.4 million and depreciation and amortization of $12.2 million. Changes in asset and liability accounts used $1.1 million of net cash during the nine months ended September 30, 2010.

We anticipate negative cash flow from operations in the near future as we continue to support the anticipated growth of our business.

Cash Flows From Investing Activities

Cash flows from investing activities primarily relate to capital expenditures to support our growth.

Cash used in investing activities totaled $74.5 million during the nine months ended September 30, 2011 and consisted of capital expenditures of $113.7 million primarily related to the purchase of manufacturing equipment and a decrease in restricted cash of $10.5 million. During the nine months ended September 30, 2011, we received government grant proceeds of $32.0 million related to reimbursements for capital expenditures previously incurred. The reimbursements received for the nine months ended September 30, 2011 primarily relate to our DOE Battery Initiative grant.

Cash used in investing activities totaled $74.6 million during the nine months ended September 30, 2010 and consisted of capital expenditures of $107.8 million primarily related to the purchase of manufacturing equipment, expenditures of $14.9 million related to the purchase of a long-term investment, an increase in restricted cash of $1.6 million and receipt of government grant proceeds of $49.6 million.

We anticipate additional capital expenditure levels in future periods as we continue to fund the expansion of our facilities to support the anticipated growth of our business. Additionally, we anticipate

Table of Contents

investing cash outflows in future periods as we invest in joint ventures and other equity investments in order to establish strategic relationships.

Cash Flows From Financing Activities

Cash flows provided by financing activities totaled $281.4 million during the nine months ended September 30, 2011 and included proceeds from the issuance of debt, net of offering costs of $138.8 million, proceeds from the issuance of common stock, net of issuance costs paid, of $115.2 million, proceeds from revolving credit lines of $38.1 million, proceeds from the exercise of stock options of $2.0 million and proceeds from government grants of $0.9 million. These proceeds were partially offset by repayments on revolving credit line and long-term debt of $12.0 million and payments on capital lease obligations of $2.1 million.

Cash used in financing activities totaled $4.6 million during the nine months ended September 30, 2010 and included proceeds from government grants of $7.3 million and proceeds from exercise of stock options of $3.1 million. These proceeds were partially offset by repayments on long-term debt of $5.2 million, and repayments on capital lease obligations of $0.5 million.

In future periods, we expect financing activities such as proceeds from grants, equity offerings and debt issuances to be a significant source of cash. If we are unable to raise additional capital, there would be uncertainty regarding our ability to maintain liquidity sufficient to operate our business effectively over the next twelve months.

Credit Facilities

As of September 30, 2011, we hold a term loan with a financial institution that requires us to comply with certain covenants, which include a minimum liquidity ratio calculation. Additionally, we may not create, incur, assume or be liable for indebtedness, except for permitted indebtedness, or create, incur or allow any lien on our property, except for permitted liens. Under the term loan agreement, an event of default would occur if we fail to pay any obligation due or fail or neglect to perform, keep or observe any material term provision, condition, covenant or agreement within the term loan agreement, and do not, or are unable to cure the default within the allowed grace period, or a material adverse change in our business occurs. Upon an event of default, the financial institution may declare all obligations immediately due and payable, it may stop advancing money or extending credit or it may apply against the obligation balances and deposits which we hold with the financial institution, among other remedies available to the financial institution under the terms of the term loan agreement. On September 30, 2011, we also entered into a Credit Agreement, providing us with a revolving loan facility in an aggregate principal amount of up to the lesser of (i) $40.0 million or (ii) a Borrowing Base (as defined in the credit agreement) established at 80% of certain eligible accounts, 15% of certain eligible foreign accounts and 30% of certain eligible inventory, as more specifically described in the agreement. The agreement also provides a letter of credit sub-facility in an aggregate principal amount of up to $10.0 million and a swing-line loan sub-facility in an aggregate principal amount of up to $5.0 million. Any outstanding obligations under either the letter of credit sub-facility or swing-line sub-facility deduct from the availability under the $40.0 million revolving facility. The credit agreement additionally provides a discretionary incremental facility in an aggregate principal amount of not less than $10.0 million and up to $35.0 million. The funding of the incremental facility is discretionary on the part of the lenders and will depend on market conditions and other factors. The credit agreement permits us to enter into cash management and hedging agreements with the lenders.

The maturity date for any revolving cash borrowings under the Agreement is September 30, 2014. We borrowed the $40.0 million at September 30, 2011 and repaid the total outstanding of $8.0 million on the existing revolving loan. The remaining funds will be used for working capital and general corporate purposes. As of September 30, 2011, we had $0 available to borrow under this facility.

Table of Contents

Revolving cash borrowings under the Agreement will bear interest at (i) the Eurodollar Rate (as defined in the Agreement), plus 0.225% (if our liquidity is greater than $75.0 million) or 0.275% (if our liquidity is equal to or less than $75.0 million) per annum, and/or (ii) the base rate (customarily defined), plus 0.50% (if the our liquidity is equal to or less than $75.0 million) per annum.

Amounts outstanding under the agreement (including any cash management or hedging agreements as provided in the agreement) are secured by substantially all of our existing and future assets, except intellectual property and certain other exceptions as set forth in the Agreement and related security documents.

The Agreement contains the following financial covenants:

(a) We must maintain (i) a Consolidated Liquidity Ratio of at least 2.00 to 1.00, and (ii) a liquidity of at least $50.0 million; and

(b) Our Consolidated Tangible Net Worth (as defined in the Agreement) must be at least $400.0 million.

Additionally, we may not create, issue, incur, assume or be liable in respect of or suffer to exist, any indebtedness, except for permitted indebtedness or create, incur, assume or suffer to exist, any lien on its property, except for permitted liens. Under the credit agreement, an event of default would occur we fail to pay any obligation due or fail or neglect to perform, keep or observe any material term provision, condition, covenant or agreement within the credit agreement, and do not, or are not able to remedy the default within the allowed grace period, or a material adverse change in our business occurs. Upon an event of default, the financial institution may declare all obligations immediately due and payable, it may stop advancing money or extending credit or it may apply against the obligation balances and deposits which we hold with the financial institution, among other remedies available to the financial institution under the terms of the credit agreement.

As of September 30, 2011, we are in compliance with the covenants and terms of the agreements.

Off-Balance Sheet Arrangements

In June 2010, we entered into a supply agreement under which we committed to minimum purchase volumes for each of the years ending December 31, 2010 through December 31, 2013 for a raw material component. If our purchase volumes during any year fail to meet the minimum purchase commitments, we are required to pay the seller a variance payment for the difference between the amount actually purchased in that calendar year and the annual minimum purchase commitment for that calendar year. We will receive a credit for the amount of the variance payment to be applied to purchases in the following year and we will have until April 1, 2015 to reclaim any variance payment resulting from the minimum purchase commitments for calendar years 2012 or 2013. The table shown below in the section titled "Contractual Obligations" shows the amount of our purchase commitments payable by year inclusive of our commitment under the supply agreement described above. For the nine months ended September 30, 2011, we have purchased $6.7 million under this supply agreement.

During the periods presented, we did not have and do not currently have, any off-balance sheet arrangements, as defined under SEC rules, such as relationships with unconsolidated entities or financial partnerships, which are often referred to as structured finance or special purpose entities, established for the purpose of facilitating financing transactions that are not required to be reflected on our balance sheet, other than the arrangement described above.

Contractual Obligations

Our contractual obligations relate primarily to borrowings under long-term debt obligations, capital leases, operating leases, and purchase obligations which include agreements or purchase orders to purchase goods or services that are enforceable and legally binding. A table summarizing the amounts and estimated timing of these future cash payments was provided in our Annual Report on Form 10-K for the year ended December 31, 2010 as filed with the SEC on March 11, 2011. During the nine months ended September 30, 2011, there were no material changes outside the ordinary course of business in our contractual obligations or the estimated timing of the future cash payments, except as noted below.

The following is a summary of our purchase obligations as of September 30, 2011:

	Payments Due in		
	Total	Less than 1 Year	1 - 3 Years
		(in thousands)	
Purchase obligations(1)	138,344	101,344	37,000
	$ 138,344	$ 101,344	$ 37,000

(1) Capital expenditure purchase obligations include agreements or purchase orders to purchase capital goods that are enforceable and legally binding and specify all significant terms. Purchase obligations exclude agreements that are cancelable without penalty.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As of September 30, 2011, we have not experienced any adverse changes in market risk exposures that materially affected the quantitative and qualitative disclosures presented in the Company's Annual Report on Form 10-K for the year ended December 31, 2010 as filed with the SEC on March 11, 2011. Our convertible notes issued in April 2011 have a fixed interest rate and therefore we are not subject to interest rate sensitivity on these instruments.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures. Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2011. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of September 30, 2011, our chief executive officer and our chief financial officer concluded that, as of such date, our disclosure controls and procedures were not effective at the reasonable assurance level.

As disclosed in our Annual Report on Form 10-K for the year ended December 31, 2010, filed with the SEC on March 11, 2011, we identified a material weakness in our internal control over financial reporting. We intend to take appropriate and reasonable steps to make necessary improvements to our internal control over financial reporting. We expect that our remediation efforts, including design, implementation and testing will continue throughout fiscal year 2011, although the material weakness will not be considered remediated until our controls are operational for a period of time, tested, and management concludes that these controls are operating effectively.

Changes in Internal Controls. No changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the quarterly period ended September 30, 2011 that have materially affected, or are reasonably likely to materially affect our internal control over financial reporting other than described below. As disclosed in Item 9A: *Controls and Procedures,* of our Annual Report on Form 10-K for the year ended December 31, 2010, as filed with the SEC on March 11, 2011, our former Chief Financial Officer left the company in January 2011. In May 2011, our new Chief Financial Officer joined the Company and assumed the role of principal financial and accounting officer following the departure of our former controller and principal accounting officer later that month. The role of principal accounting officer was given to our Chief Accounting Officer who joined the Company in July 2011.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In 2005 and 2006, we received communications from Hydro-Quebec, a Canadian utility company, alleging that the cathode material of our batteries infringes U.S. Patent No. 5,910,382 and U.S. Patent No. 6,514,640 that had been granted to The University of Texas, or UT, and that relate to certain electrode materials used in lithium-ion batteries. We refer to these patents by the last three digits of the patent number. The '382 and '640 patents include claims that claim to cover battery cathode material having a particular crystal structure and chemical formula. We contended that our cathode material has a different crystal structure and chemical formula.

We believe that UT subsequently licensed the patents to Hydro-Quebec, which in turn licensed the technology to companies that make and sell electrode materials for batteries. On April 7, 2006, we commenced an action in the United States District Court for the District of Massachusetts seeking a declaratory judgment that our products do not infringe these patents and that the patents are invalid. On September 8, 2006, we also requested ex parte reexamination of the two patents by the U.S. Patent & Trademark Office, or PTO, to determine whether the subject matter they claimed is patentable.

On September 11, 2006, Hydro-Quebec and UT commenced an action in the United States District Court for the Northern District of Texas against us, one of our customers, Black & Decker, whom we have agreed to indemnify, and one of our suppliers alleging infringement of the two patents and, in a later amended complaint, false advertising. The plaintiffs' complaint alleged infringement of various claims of the '382 Patent and various claims of the '640 Patent and that we and Black & Decker had engaged in false advertising by making representations about the source and nature of our technology. The complaint sought injunctive relief, including against making, using or selling any product containing the patented technology, actual damages in an unspecified amount, increased and/or treble damages, interest, costs and attorney fees.

Table of Contents

In October 2006 and January 2007, the PTO granted our requests for reexamination of the two patents. In January and February 2007, the two litigations in Massachusetts and Texas were stayed pending the PTO reexaminations. During the reexamination, the PTO rejected all of the original claims of the '382 Patent as unpatentable. UT then amended the claims of the '382 Patent to make them narrower than the original claims in order to distinguish the claimed invention from the prior art and added two new and narrower claims. The PTO determined that the narrower amended and new claims of the '382 Patent submitted during reexamination are patentable and concluded the reexamination of the '382 Patent. On April 15, 2008, the PTO issued a reexamination certificate with the amended claims and the two new claims. During the reexamination of the '640 Patent, the PTO rejected all of the original claims of the '640 Patent as unpatentable. UT then amended the claims of the '640 Patent to make them narrower than the original claims in order to distinguish the claimed invention from the prior art. On May 12, 2009, the PTO issued a Certificate of Reexamination for the '640 Patent with the amended narrower claims, thus allowing Hydro-Quebec and UT to assert the narrower claims of the Certificate of Reexamination against any alleged infringer, including us.

On July 22, 2009, Hydro-Quebec and UT sent us a proposed Second Amended Complaint in the Texas litigation, which was filed with the Texas court on August 27, 2009 and we were granted several unopposed extensions to file our response. The Texas court re-opened the case and lifted the stay on October 26, 2009. The Texas court held a hearing with the parties on May 14, 2010 and extended a schedule for the case leading to a claim construction hearing, which was held on December 2, 2010. On March 29, 2011, the Texas court issued a Memorandum Opinion and Order on Claim Construction. The court issued a scheduling order on April 27, 2011, and trial was set to begin in December 2011. On June 7, 2011, Hydro-Quebec filed a new complaint in the United States District Court for the Northern District of Texas against us and other companies alleging infringement of a newly-issued continuation patent (U.S. Patent No. 7,955,733) to one of the patents in the existing action. Hydro-Quebec then amended this complaint to include three additional continuation patents (U.S. Patent Nos. 7,960,058, 7,964,308, and 7,972,728) that have subsequently issued. We requested reexamination by the PTO of three of the continuation patents in suit. On June 27, 2011, the parties engaged in a court ordered mediation session in New York City before the Honorable John Lifland, a retired federal judge.

On October 31, 2011, we entered into a Settlement Agreement and related Patent Sublicense Agreement with Hydro-Quebec and UT thereby settling the patent disputes and resolving the existing litigations. The parties have agreed to dismiss all litigations and we were granted a license under the related patents.

Item 1A. Risk Factors

Our business is subject to numerous risks. We caution you that the following important factors, among others, could cause our actual results to differ materially from those expressed in forward-looking statements made by us or on our behalf in filings with the SEC, press releases, communications with investors and oral statements. Any or all of our forward-looking statements in this Quarterly Report on Form 10-Q and in any other public statements we make may turn out to be wrong. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties. Many factors mentioned in the discussion below will be important in determining future results. Consequently, no forward-looking statement can be guaranteed. Actual future results may differ materially from those anticipated in forward-looking statements. We undertake no obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise. You are advised, however, to consult any further disclosure we make in our reports filed with the SEC.

Table of Contents

Risks Related to Our Business

We have had a history of losses, and we may be unable to achieve or sustain profitability.

We have never been profitable. We experienced net losses of $86.6 million for 2009, $152.9 million for 2010 and $172.8 million for the nine months ended September 30, 2011. We expect we will continue to incur net losses in the near term. We expect to incur significant future expenses as we develop and expand our business and our manufacturing capacity. In addition, as a public company, we have incurred and will continue to incur additional significant legal, accounting and other expenses that we did not incur as a private company. These increased expenditures will make it harder for us to achieve and maintain future profitability. We may incur significant losses in the future for a number of reasons, including the other risks described in this section, and we may encounter unforeseen expenses, difficulties, complications, delays and other unknown events. Accordingly, we may not be able to achieve or maintain profitability.

We have yet to achieve positive cash flow, and our ability to generate positive cash flow is uncertain.

To rapidly develop and expand our business, we have made significant up-front investments in our manufacturing capacity and incurred research and development, sales and marketing and general and administrative expenses. In addition, our growth has required a significant investment in working capital over the last several years. We have had negative cash flow before financing activities of $114.7 million for 2009, $250.4 million for 2010 and $272.4 million for the nine months ended September 30, 2011. We anticipate that we will continue to have negative cash flow for the foreseeable future. Our business will also require significant amounts of working capital to support our growth. Therefore, we may need to raise additional capital from investors to achieve our expected growth, and we may not achieve sufficient revenue growth to generate positive future cash flow. An inability to generate positive cash flow for the foreseeable future or raise additional capital on reasonable terms may decrease our long-term viability.

If we are unable to obtain supplies of materials we use in the electrode coating process of our batteries sufficient to meet our planned demand levels, our results of operations could be materially adversely affected.

Our supply of materials we use in the electrode coating process of our batteries was disrupted by the earthquake and tsunami that occurred in Japan on March 11, 2011. We currently have inventory of these materials on hand, in transit, or committed from our supplier that we believe will support our manufacturing operations through December 2012. However, if we are not able to obtain these or additional materials from our supplier, or if there is a prolonged disruption in our suppliers' manufacturing capability and we are delayed or are not able to qualify a second source of supply, our results of operations would be materially adversely affected and we would not be able to achieve our planned financial results. We are not currently aware of any other supply issue related to the earthquake in Japan affecting our business. Our automotive customers comprise a substantial portion of our current and projected future revenue, and any such disruption in their supply chain or further disruption in our supply chain, or even the potential for such disruption, could cause delays in our programs and have a material adverse affect on our business, results of operations and financial outlook.

Our limited operating history makes it difficult to evaluate our current business and future prospects.

We have been in existence since 2001, but much of our growth has occurred in recent years. Our limited operating history may make it difficult to evaluate our current business and our future prospects. We have encountered and will continue to encounter risks and difficulties frequently experienced by growing companies in rapidly changing industries, including increasing expenses as we

Table of Contents

continue to grow our business. If we do not manage these risks successfully, our business will be harmed.

In addition, we are targeting new and emerging markets for our batteries and battery systems. However, historically, a significant portion of the products that we have sold were designed for the consumer tool market, which is a more mature market with different growth prospects than our other target markets. Several of our products are still under development, and the timing of the ultimate release, if any, of new production quality products is not determinable. Our efforts to expand beyond our existing markets may never result in new products that achieve market acceptance, create additional revenue or become profitable. Therefore, our recent historical growth trajectory may not provide an accurate representation of the market dynamics we may be exposed to in the future, making it difficult to evaluate our future prospects.

The demand for batteries in the transportation and other markets depends on the continuation of current trends resulting from dependence on fossil fuels. Extended periods of low gasoline prices could adversely affect demand for electric and hybrid electric vehicles.

We believe that much of the present and projected demand for advanced batteries in the transportation and other markets results from increases in the cost of oil over the last several years, the dependency of the United States on oil from unstable or hostile countries, government regulations and economic incentives promoting fuel efficiency and alternate forms of energy, as well as the belief that climate change results in part from the burning of fossil fuels. If the cost of oil decreased significantly, the outlook for the long-term supply of oil to the United States improved, the government eliminated or modified its regulations or economic incentives related to fuel efficiency and alternate forms of energy, or if there is a change in the perception that the burning of fossil fuels negatively impacts the environment, the demand for our batteries could be reduced, and our business and revenue may be harmed.

Gasoline prices have been extremely volatile, and this continuing volatility is expected to persist. Lower gasoline prices over extended periods of time may lower the perception in government and the private sector that cheaper, more readily available energy alternatives should be developed and produced. If gasoline prices remain at deflated levels for extended periods of time, the demand for hybrid and electric vehicles may decrease, which would have a material adverse effect on our business.

If we are unable to develop, manufacture and market products that improve upon existing battery technology and gain market acceptance, our business may be adversely affected. In addition, many factors outside of our control may affect the demand for our batteries and battery systems.

We are researching, developing, manufacturing and selling lithium-ion batteries and battery systems. The market for advanced rechargeable batteries is at a relatively early stage of development, and the extent to which our lithium-ion batteries will be able to meet our customers' requirements and achieve significant market acceptance is uncertain. Rapid and ongoing changes in technology and product standards could quickly render our products less competitive, or even obsolete if we fail to continue to improve the performance of our battery chemistry and systems. Other companies that are seeking to enhance traditional battery technologies have recently introduced or are developing batteries based on nickel metal-hydride, liquid lithium-ion and other emerging and potential technologies. These competitors are engaged in significant development work on these various battery systems. One or more new, higher energy rechargeable battery technologies could be introduced which could be directly competitive with, or superior to, our technology. The capabilities of many of these competing technologies have improved over the past several years. Competing technologies that outperform our batteries could be developed and successfully introduced, and as a result, our products may not compete effectively in our target markets. If our battery technology is not adopted by our customers, or if our battery technology does not meet industry requirements for power and energy storage capacity in an efficient and safe design, our batteries will not gain market acceptance.

Table of Contents

In addition, the market for our products depends upon third parties creating or expanding markets for their end-user products that utilize our batteries and battery systems. If such end-user products are not developed, if we are unable to have our products designed into these end user products, if the cost of these end-user products is too high, or the market for such end-user products contracts or fails to develop, the market for our batteries and battery systems would be expected similarly to contract or collapse. Our customers operate in extremely competitive industries, and competition to supply their needs focuses on delivering sufficient power and capacity in a cost, size and weight efficient package. The ability of our customers to adopt new battery technologies will depend on many factors outside of our control. For example, in the automotive industry, we depend on our customers' ability to develop HEV, PHEV and EV platforms that gain broad appeal among end users.

Many other factors outside of our control may also affect the demand for our batteries and battery systems and the viability of widespread adoption of advanced battery applications, including:

- performance and reliability of battery power products compared to conventional and other non-battery energy sources and products;
- success of alternative battery chemistries, such as nickel-based batteries, lead-acid batteries and conventional lithium-ion batteries and the success of other alternative energy technologies, such as fuel cells and ultra capacitors;
- end-users' perceptions of advanced batteries as relatively safe and reliable energy storage solutions, which could change over time if alternative battery chemistries prove unsafe or become the subject of significant product liability claims and negative publicity is generated on the battery industry as a whole;
- cost-effectiveness of our products compared to products powered by conventional energy sources and alternative battery chemistries;
- availability of government subsidies and incentives to support the development of the battery power industry;
- fluctuations in economic and market conditions that affect the cost of energy stored by batteries, such as increases or decreases in the prices of electricity;
- continued investment by the federal government and our customers in the development of battery powered applications;
- heightened awareness of environmental issues and concern about global warming and climate change; and
- regulation of energy industries.

Our principal competitors have, and any future competitors may have, greater financial and marketing resources than we do, and they may therefore develop batteries or other technologies similar or superior to ours or otherwise compete more successfully than we do.

Competition in the battery industry is intense. The industry consists of major domestic and international companies, most of which have existing relationships in the markets into which we sell as well as financial, technical, marketing, sales, manufacturing, scaling capacity, distribution and other resources and name recognition substantially greater than ours. These companies may develop batteries or other technologies that perform as well as or better than our batteries. We believe that our primary competitors are existing suppliers of cylindrical lithium-ion, nickel cadmium, nickel metal-hydride and in some cases, non-starting/lighting/ignition lead-acid batteries. A number of our competitors have existing and evolving relationships with our target customers. For example, Bosch and Samsung formed SB LiMotive to focus on the development, production and marketing of lithium-ion battery systems for

Table of Contents

application in hybrid and other electric vehicles, and Dow Chemical has entered into a joint venture with Kokam America and others, to build a facility in Michigan for the manufacture of lithium polymer batteries for use in HEVs and EVs. In addition, NEC Corporation and Nissan entered into a joint venture to develop lithium-ion batteries in prismatic form, Sanyo and Volkswagen agreed to develop lithium-ion batteries for HEVs, Sanyo is providing nickel metal hydride batteries for Ford and Honda, and Toyota and Panasonic are engaged in a joint venture to make batteries for HEVs and EVs. LG Chem and its subsidiary, Compact Power, have also developed lithium-ion battery systems for hybrid and other electric vehicles. These competitors may be able to offer lower prices for their batteries than we can offer, and may even sell their batteries at below their production costs in order to compete with us, particularly in the transportation market. In addition, we expect new competitors will enter the markets for our products in the future. Potential customers may choose to do business with our more established competitors, because of their perception that our competitors are more stable, are more likely to complete various projects, can scale operations more quickly, have greater manufacturing capacity, are more likely to continue as a going concern and lend greater credibility to any joint venture. If we are unable to compete successfully against manufacturers of other batteries or technologies in any of our targeted applications, our business could suffer, and we could lose or be unable to gain market share.

Adverse business or financial conditions affecting the automobile industry have had, and may continue to have, a material adverse effect on our development and marketing partners and our battery business.

Much of our business depends on and is directly affected by the general economic state of the United States and global automobile industry. The effect of the continued economic difficulties of the major automobile manufacturers on our business is unclear. Two major auto manufacturers have emerged from bankruptcy, and it is possible that more of these companies may encounter financial difficulties. The impact of any such financial difficulties on the automobile industry and its suppliers is unclear and difficult to predict. Possible effects could include reduced spending on alternative energy systems for automobiles, a delay in the introduction of new, or the cancellation of new and existing, hybrid and electric vehicles and programs, and a delay in the conversion of existing batteries to lithium-ion batteries, each of which would have a material adverse effect on our business.

We have entered into agreements relating to joint design and development efforts with several automotive manufacturers and tier 1 suppliers regarding their HEV, PHEV and EV development efforts. Certain of these manufacturers and suppliers have in recent years experienced static or reduced revenues, increased costs, net losses, loss of market share, bankruptcy, labor issues and other business and financial challenges. As a result, these or other automotive manufacturers may discontinue or delay their planned introduction of HEVs, PHEVs or EVs as a result of adverse changes in their financial condition or other factors. Automotive manufacturers may also seek alternative battery systems from other suppliers which may be more cost-effective or require fewer modifications in standard manufacturing processes than our products. We may also experience delays or losses with respect to the collection of payments due from customers in the automotive industry experiencing financial difficulties.

We have experienced rapid growth in recent periods. If we fail to manage our growth effectively, we may be unable to execute our business plan, maintain high levels of service or address competitive challenges adequately.

We increased our number of full-time employees from 904 at January 1, 2008 to 2,032 at December 31, 2010, and our revenue increased from $68.5 million in 2008 to $97.3 million in 2010. Our growth has placed, and may continue to place, a significant strain on our managerial, administrative, operational, financial, information technology and other resources. Expanding a global organization and managing a geographically dispersed workforce will require substantial management effort and significant additional investment in our infrastructure. We will be required to continue to improve our operational, financial and management controls and our reporting procedures and we may not be able to do so effectively. As such, we may be unable to manage our expenses effectively in the future, which may negatively impact our operating results in any particular quarter.

Our failure to raise additional capital necessary to expand our operations and invest in our products and manufacturing facilities could reduce our ability to compete successfully.

We may need to raise additional capital in the future to fund our growth and expansion plans and we may not be able to obtain additional debt or equity financing on favorable terms, if at all. If we raise additional equity financing, our stockholders may experience significant dilution of their ownership interests, and the per-share value of our common stock could decline. For example, in April 2011, we issued 20.2 million shares of common stock and $143.8 million in principal of convertible unsecured subordinated notes. The issuance of shares pursuant to these transactions resulted in dilution to stockholders who held our common stock prior to such transactions. Stockholders will also experience further dilution if holders of the convertible notes choose to convert such notes into shares of our common stock.

On November 7, 2011, we announced a series of agreements with IHI Corporation pursuant to which, we will raise $25 million through the sale of common stock.

If we engage in debt financing, we may be required to accept terms that restrict our ability to incur additional indebtedness and force us to maintain specified liquidity or other ratios. We are also seeking federal and state grants, loans and tax incentives some of which we intend to use to expand our operations. We may not be successful in obtaining these funds or incentives. If we need additional capital and cannot raise or otherwise obtain it on acceptable terms, we may not be able to, among other things:

- develop or enhance our products or introduce new products;
- continue to expand our development, sales and marketing and general and administrative organizations and manufacturing operations;
- attract top-tier companies as customers or as our technology and product development partners;
- acquire complementary technologies, products or businesses;
- expand our operations, in the United States or internationally;
- expand and maintain our manufacturing capacity;
- hire, train and retain employees; or
- respond to competitive pressures or unanticipated working capital requirements.

Because we build our manufacturing capacity based on our projection of future design wins and supply agreements, our business revenue and profits depend upon our ability to enter into and complete these agreements, successfully complete these expansion projects, achieve competitive manufacturing yields and drive volume sales consistent with our demand expectations.

In order to fulfill the anticipated demand for our products, we invest in capital expenditures in advance of actual customer orders, based on estimates of future demand. We plan to continue the expansion of our manufacturing capacity across multiple product lines. The build-up of our internal manufacturing capabilities, such as the current expansions in Livonia and Romulus, Michigan, exposes us to significant up-front fixed costs. If market demand for our products does not increase as quickly as we have anticipated and align with our expanded manufacturing capacity, or if we fail to enter into and complete projected development and supply agreements, we may be unable to offset these costs and to achieve economies of scale, and our operating results may be adversely affected as a result of high operating expenses, reduced margins, underutilization of capacity and asset impairment charges. Alternatively, if we experience demand for our products in excess of our estimates, our installed capital equipment may be insufficient to support higher production volumes, which could harm our customer relationships and overall reputation. In addition, we may not be able to expand our workforce and operations in a timely manner, procure adequate resources, or locate suitable third-party suppliers, to respond effectively to changes in demand for our existing products or to the demand for new products requested by our customers, and our current or future business could be materially and adversely affected. Our ability to meet such excess customer demand could also depend on our ability to raise additional capital and effectively scale our manufacturing operations.

We utilize standard manufacturing equipment that we modify and customize in order to meet our production needs. While this equipment may be available from various suppliers, its procurement requires long lead times. Therefore, we may experience delays, additional or unexpected costs and other adverse events in connection with our capacity expansion projects, including those associated with potential delays in the procurement and customization of manufacturing equipment and various components required for our products.

If we are unable to achieve and maintain satisfactory production yields and quality as we expand our manufacturing capabilities, our relationships with certain customers and overall reputation may be harmed, and our sales could decrease.

Revenue from our supply agreement with Fisker Automotive, Inc., or Fisker, represents, and is expected to continue to represent, a significant portion of our revenue. If Fisker is unable to fulfill its commitment under the supply agreement our revenues could be materially lower than our forecasts and we may have under-utilized manufacturing capacity.

We have a supply agreement with Fisker pursuant to which we are providing Fisker with advanced automotive battery systems over a multi-year period. If Fisker is not successful in raising additional capital necessary to fund its operations, executing on its strategic plan or does not meet the anticipated demand for our products, our revenues and profitability may be materially impacted. For example, in November 2011, we announced revised annual revenue guidance for 2011 due to an unanticipated reduction in orders from Fisker for the fourth quarter. As we invest in capital expenditures and build our manufacturing capacity in anticipation of demand, including anticipated demand from Fisker under the supply agreement, our operating results may be adversely affected by underutilization of capacity, failure to achieve economies of scale, and reduced margins if actual orders are less than expected.

We may not be able to obtain, or to agree on acceptable terms and conditions for, all or a significant portion of the government grants, loans and other incentives for which we have applied and may in the future apply. Our customers and potential customers applying for government grants, loans and other incentives may condition purchases of our products upon their receipt of these funds or delay purchases of our products until their receipt of these funds.

We have applied for federal and state grants, loans and tax incentives under government programs designed to stimulate the economy and support the production of electric vehicles and advanced battery technologies, including a loan under the DOE ATVM Program. Much of our planned domestic manufacturing capacity expansion depends on receipt of these funds and other incentives, and the failure to obtain these funds or other incentives could materially and adversely affect our ability to expand our manufacturing capacity and meet planned production levels. Given recent bankruptcies declared by some recipients of loans under the DOE ATVM Program and resulting congressional investigations into the DOE ATVM Program, we anticipate that pending loan applications, including our own, may be further delayed. We anticipate that in the future there will be new opportunities for us to apply for grants, loans and other incentives from the United States, state and foreign governments. Our ability to obtain funds or incentives from government sources is subject to the availability and continued availability of funds under applicable government programs and approval of our applications to participate in such programs. The application process for these funds and other incentives is and will be highly competitive. While we have received a grant under the DOE Battery Initiative and have received some state incentives, we cannot assure you that we will be successful in obtaining additional grants, loans and other incentives. Moreover, we may not be able to satisfy or continue to satisfy the requirements and milestones imposed by the granting authority as conditions to receipt of the funds or other incentives, the timing of the receipt of the funds may not meet our needs and we nevertheless may be unable to successfully execute on our business plan. Moreover, not all of the terms and conditions associated with these incentive funds have been disclosed to us, and once disclosed, there may be terms and conditions with which we are unable to comply or which are commercially unacceptable to us. In addition, the DOE Battery initiative grant and any other federal government programs which may make additional awards to us will require us to spend a portion of our own funds for every incentive dollar we receive or are permitted to borrow from the government and will impose time limits during which we must use the funds awarded to us. If we are unable to raise sufficient additional capital so that we are able to receive all of the amounts which have and may be awarded to us in a timely manner, our ability to expand our manufacturing capacity could be materially adversely affected. In addition, less than expected actual and anticipated future demand for our products may cause us to slow the pace of the expansion of our manufacturing capacity such that we are not able to use the government incentive funds awarded or made available to us in the time periods required by the granting authorities.

Our customers and potential customers applying for these government grants, loans and other incentives may condition purchases of our products upon receipt of these funds or delay purchases of our products until receipt of these funds, and if our customers and potential customers do not receive these funds or the receipt of these funds is significantly delayed, our results of operations could suffer.

We are subject to government audits related to the government grants, loans and other incentives we have received. If the findings of the audit determine we have not met the requirements of the grant, loan or other incentive, we may be required to repay all or part of the amount received to the government authority.

We have received funds under federal and state grant and loan programs. Under the terms and conditions of the programs, we are subject to governmental audits of the amounts submitted for reimbursement of costs incurred. Although we expect to satisfy the requirements of the grants, loans, and other incentives received, we cannot assure that the government audits will not result in determining that a portion of the costs submitted for reimbursement do not comply with the conditions of the grant. If we do not meet the conditions of the grants, loans or other incentives, we may be required to repay all or a portion of the proceeds received to date from the federal or state agencies.

We rely on a limited number of customers for a significant portion of our revenue, and the loss of, or delay in the production process, of one or more of our most significant customers, or several of our smaller customers, could materially harm our business.

A significant portion of our revenue is generated from a limited number of customers. For the years ended December 31, 2009 and 2010, revenue from our two largest customers represented 45% and 41% of our revenue, respectively. Although the composition of our significant customers will vary from period to period, we expect that most of our revenue will continue, for the foreseeable future, to come from a relatively small number of customers. In addition, our contracts with our customers generally do not include long-term commitments or minimum volumes that ensure future sales of our products. Consequently, our financial results may fluctuate significantly from period-to-period based on the actions of one or more significant customers. A customer may take actions that affect us for reasons that we cannot anticipate or control, such as reasons related to the customer's financial condition, changes in the customer's business strategy or operations, the introduction of alternative

Table of Contents

competing products, or as the result of the perceived quality or cost-effectiveness of our products. Our agreements with these customers may be cancelled if we fail to meet certain product specifications or materially breach the agreement or for other reasons outside of our control. In addition, our customers may seek to renegotiate the terms of current agreements or renewals. The loss of or a reduction in sales or anticipated sales to our most significant or several of our smaller customers could have a material adverse effect on our business, financial condition and results of operations. For example, in November 2011, we announced revised annual revenue guidance for 2011 due to an unanticipated reduction in orders from Fisker for the fourth quarter. Additionally, if one of our significant customers, several of our smaller customers, or one of our existing supply agreements with customers for significant future revenues experiences a delay in production, or their product is not successful, our business, financial condition and results of operations could be materially harmed.

Our financial results may vary significantly from period-to-period due to the long and unpredictable sales cycles for some of our products, the seasonality of certain end markets into which we sell our products, and changes in the mix of products we sell during a period, which may lead to volatility in our stock price.

The size and timing of our revenue from sales to our customers is difficult to predict and is market dependent. Our sales efforts often require us to educate our customers about the use and benefits of our products, including their technical and performance characteristics. Customers typically undertake a significant evaluation process that has in the past resulted in a lengthy sales cycle, which is typically many months and in some cases up to five years. In some markets such as the transportation market, there is usually a significant lag time between the design phase and commercial production. We spend substantial amounts of time and money on our sales efforts and there is no assurance that these investments will produce any sales within expected time frames or at all. For example, we have previously spent substantial time and money on several designs with auto manufacturers that were ultimately awarded to another supplier. Given the potentially large size of battery development and supply contracts, the loss of or delay in the signing of a contract or a customer order could significantly reduce our revenue in any period. Since most of our operating and capital expenses are incurred based on the estimated number of design wins and their timing, they are difficult to adjust in the short term. As a result, if our revenue falls below our expectations or is delayed in any period, we may not be able to reduce proportionately our operating expenses or manufacturing costs for that period, and any reduction of manufacturing capacity could have long-term implications on our ability to accommodate future demand.

Our profitability from period-to-period may also vary significantly due to the mix of products that we sell in different periods. While we have sold most of our products to date into the commercial market, we are also focusing our sales efforts on applications in the transportation and electric grid markets. Products in these other markets have different cost profiles and are governed by different business dynamics. Consequently, sales of individual products may not necessarily be consistent across periods, which could affect product mix and cause gross and operating profits to vary significantly.

In addition, since our batteries and battery systems are incorporated into our customers' products for sale into their respective end markets, our business is exposed to the seasonal demand that may characterize some of our customers' own product sales. Because many of our expenses are based on anticipated levels of annual revenue, our business and operating results could also suffer if we do not achieve revenue consistent with our expectations for this seasonal demand.

As a result of these factors, we believe that quarter-to-quarter comparisons of our operating results are not necessarily meaningful and that these comparisons cannot be relied upon as indicators of future performance. Moreover, our operating results may not meet expectations of equity research analysts or investors. If this occurs, the trading price of our common stock could fall substantially either suddenly or over time.

Table of Contents

We face risks related to our outstanding indebtedness.

As of September 30, 2011, we had total indebtedness of $184.0 million. Our indebtedness could have significant negative consequences, including:

- increasing our vulnerability to general adverse economic and industry conditions,
- limiting our ability to obtain additional financing,
- requiring the dedication of a substantial portion of any cash flow from operations to service our indebtedness, thereby reducing the amount of cash flow available for other purposes, including capital expenditures,
- limiting our flexibility in planning for, or reacting to, changes in our business and the industry in which we compete, and
- placing us at a possible competitive disadvantage to less leveraged competitors and competitors that have better access to capital resources.

We may not be able to generate sufficient cash to service all of our indebtedness, including the convertible notes. Our ability to generate cash depends on many factors beyond our control. We may be forced to take other actions to satisfy our obligations under our indebtedness, which may not be successful.

Our ability to make payments on, and to refinance, our indebtedness, including the convertible notes, and to fund planned capital expenditures, research and development efforts, working capital, acquisitions and other general corporate purposes depends on our ability to generate cash in the future. This, to a certain extent, is subject to general economic, financial, competitive, legislative, regulatory and other factors, some of which are beyond our control. If we do not generate sufficient cash flow from operations or if future borrowings are not available to us in an amount sufficient to pay our indebtedness, including the convertible notes, or to fund our liquidity needs, we may be forced to:

- refinance all or a portion of our indebtedness, including the convertible notes, on or before the maturity thereof;
- sell assets;
- reduce or delay capital expenditures; or
- seek to raise additional capital.

In addition, we may not be able to affect any of these actions on commercially reasonable terms or at all. Our ability to refinance this indebtedness will depend on our financial condition at the time, the restrictions in the instruments governing our indebtedness and other factors, including market conditions.

Our inability to generate sufficient cash flow to satisfy our debt service obligations, or to refinance or restructure our obligations on commercially reasonable terms or at all, would have an adverse effect, which could be material, on our business, financial condition and results of operations, as well as our ability to satisfy our obligations in respect of the convertible notes.

If our products fail to perform as expected, or have technical issues, we could lose existing and future business, and our ability to develop, market and sell our batteries and battery systems could be harmed.

Our products are complex and could have unknown defects or errors, which may give rise to claims against us, diminish our brand or divert our resources from other purposes. Despite testing, new and existing products have contained defects and errors and may in the future contain manufacturing or design defects, errors or performance problems when first introduced, when new versions or enhancements are released, or even after these products have been used by our customers for a period

Table of Contents

of time. These problems could result in expensive and time-consuming design modifications or warranty charges, delays in the introduction of new products or enhancements, significant increases in our service and maintenance costs, exposure to liability for damages, damaged customer relationships and harm to our reputation, any of which may adversely affect our business and our operating results. For example, in 2010, we identified several significant technical issues in the manufacturing scale-up of our prismatic batteries. Although we identified and have taken corrective actions for these issues, the problems encountered resulted in a higher yield loss in ramp-up production, temporary halts in the production process and the distraction of personnel, some or all of which could re-occur.

Our success in the transportation market depends, in part, on our ability to design, develop and commercially manufacture lithium-ion batteries in prismatic form and battery systems for use in HEVs, PHEVs and EVs currently being developed and that may be developed in the future. The design and development of a lithium-ion battery in prismatic form and battery systems for use in the transportation industry is complex, expensive, time-consuming and subject to rigorous quality and performance requirements. If we are unable to design, develop and commercially manufacture lithium-ion batteries in prismatic form in a timely fashion and that are accepted for use in the transportation industry, our business and operating results may be adversely affected.

We entered into a strategic investment agreement with an early stage entity with which we have a commercial relationship.

In January 2010, we entered into an agreement with Fisker, a privately-held company, to invest $13.0 million in cash and 479,282 shares of our common stock, which when transferred to Fisker had a value of approximately $7.5 million. In exchange, we received shares of convertible preferred stock in Fisker which are not liquid, and we do not expect that they will be liquid for some time. Our investment in Fisker exposes us to equity price risk; if Fisker does not execute on its strategic plan, our investment may not be recovered. This investment is subject to risk of changes in fair value, which could result in a material realized impairment loss.

We have identified a material weakness in our internal control over financial reporting which are unremediated and if we fail to remediate these weakness and maintain proper and effective internal controls, our ability to produce accurate and timely financial statements could be impaired, which could harm our operating results, our ability to operate our business and investors' views of us.

Ensuring that we have adequate internal financial and accounting controls and procedures in place so that we can produce accurate financial statements on a timely basis is a costly and time-consuming effort that needs to be evaluated frequently. We have identified a material weakness in our internal control over financial reporting. A material weakness is defined as a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis by the company's internal controls.

Management identified a material weakness in our internal controls and information technology controls over the financial statement close and reporting process for the year ended December 31, 2010. Also, our former Chief Financial Officer left the company in January 2011 and, as a result, on an interim basis, our then-Vice President of Finance and Corporate Controller also fulfilled the role as the interim Chief Financial Officer until our current Chief Financial Officer joined the Company on May 12, 2011. Consequently, we had a lack of continuity of senior financial management during the preparation of our annual report for the year ended December 31, 2010. For a detailed discussion of the material weakness, see *"Controls and Procedures"* section within Part II, Item 9A of our Annual Report on Form 10-K for the year ended December 31, 2010, filed with the SEC on March 11, 2011.

We are in the process of taking the necessary steps to remediate the material weakness that we identified and have made enhancements to our control procedures; however, the material weakness will not be remediated until the necessary controls have been implemented and are determined to be operating effectively. We do not know the specific time frame needed to fully remediate the material weakness identified.

We cannot assure you that our efforts to fully remediate this internal control weakness will be successful or that similar material weaknesses will not recur.

Implementing any appropriate changes to our internal controls may distract our officers and employees, entail substantial costs to implement new processes and modify our existing processes and take significant time to complete. Moreover, these changes do not guarantee that we will be effective in maintaining the adequacy of our internal controls, and any failure to maintain that adequacy, or consequent inability to produce accurate financial statements on a timely basis, could increase our operating costs and harm our business. In addition, investors' perceptions that our internal controls are inadequate or that we are unable to produce accurate financial statements on a timely basis may harm our stock price and make it more difficult for us to effectively market and sell our products to new and existing customers.

If our warranty expense estimates differ materially from our actual claims, or if we are unable to estimate future warranty expense for new products, our business and financial results could be harmed.

Our warranty for our products ranges from one to eight years from the date of sale, depending on the type of product and its application. We expect that in the future some of our warranties could extend beyond eight years. In the commercial market, we typically provide a warranty against certain potential manufacturing defects, which may cause high rates of self-discharge, inaccurate voltage, and other product irregularities. In the electric grid services and transportation markets, we may also provide a warranty against a certain percentage decline in the initial power and energy density specifications of a particular product and for a warranty for system availability. Since we began selling our first products in the commercial market in the first quarter of 2006, in the transportation market in the first quarter of 2007 and in the electric grid services market in the third quarter of 2009, we have a limited product history on which to base our warranty estimates. Because of the limited operating history of our batteries and battery systems, our management is required to make assumptions and to apply judgment regarding a number of factors, including anticipated rate of warranty claims, the durability and reliability of our products, and service delivery costs. Our assumptions could prove to be materially different from the actual performance of our batteries and battery systems, which could cause us to incur substantial expense to repair or replace defective products in the future and may exceed expected levels against which we have reserved. If our estimates prove incorrect, we could be required to accrue additional expenses from the time we realize our estimates are incorrect and also face a significant unplanned cash burden at the time our customers make a warranty claim, which could harm our operating results.

In addition, with our new products and products that remain under development, we will be required to base our warranty estimates on historical experience of similar products testing of our batteries and performance information learned during our development activities with the customer. If we are unable to estimate future warranty costs for any new product, we will be required to defer recognizing revenue for that product until we are reasonably able to estimate the associated warranty expense. As a result, our financial results could vary significantly from period-to-period.

Product liability or other claims could cause us to incur losses or damage our reputation.

The risk of product liability claims and associated adverse publicity is inherent in the development, manufacturing, marketing and sale of batteries and battery systems. Certain materials we use in our batteries, as well as our batteries and battery systems, could, if used improperly, cause injuries to others. Improperly charging or discharging our batteries could cause fires. Any accident involving our batteries or other products could decrease or even eliminate demand for our products. Because some of our batteries are designed to be used in vehicles, and because vehicle accidents can cause injury to persons and damage to property, we are subject to a risk of claims for such injuries and damages. In addition, we could be harmed by adverse publicity resulting from problems or accidents caused by third party products that incorporate our batteries. For example, our business and operating results could be harmed by adverse publicity resulting from injury to persons or damage to property caused by a defective electronic system on a battery system manufactured by a third party that incorporates our batteries.

Although we have product liability insurance for our products, this may be inadequate to cover all potential product liability claims. In addition, while we often seek to limit our product liability in our contracts, such limits may not be enforceable or may be subject to exceptions. Any product recall or lawsuit seeking significant monetary damages either in excess of our coverage, or outside of our coverage, may have a material adverse affect on our business and financial condition. We may not be able to secure additional product liability insurance coverage or other available insurance coverage on acceptable terms or at reasonable costs when needed. If we were to experience a large insured loss or business interruption, it might exceed our coverage limits or may not be covered, or our insurance carriers could decline to further cover us or raise our insurance rates to unacceptable levels, any of which could impair our financial position and results of operations. A successful product liability claim against us could require us to pay a substantial monetary award. We cannot assure that such claims will not be made in the future.

We are subject to financial and reputational risks due to product recalls resulting from product quality and liability issues.

The risk of product recalls, and associated adverse publicity, is inherent in the development, manufacturing, marketing, and sale of batteries and battery systems. Our products and the products of third parties in which our products are a component are becoming increasingly sophisticated and complicated as rapid advancements in technologies occur, and as demand increases for lighter and more powerful rechargeable batteries. At the same time, product quality and liability issues present significant risks. Product quality and liability issues may affect not only our own products but also the third-party products in which our batteries and battery systems are a component. Our efforts and the efforts of our development partners to maintain product quality may not be successful, and if they are not, we may incur expenses in connection with, for example, product recalls and lawsuits, and our brand image and reputation as a producer of high-quality products may suffer. Any product recall or lawsuit seeking significant monetary damages could have a material adverse effect on our business and financial condition. A product recall could generate substantial negative publicity about our products and business, interfere with our manufacturing plans and product delivery obligations as we seek to replace or repair affected products, and inhibit or prevent commercialization of other future product candidates. Although we do have product liability insurance, we do not have insurance to cover the costs associated with a product recall and the expenses we would incur in connection with a product recall could have a material adverse affect on our operating results.

We depend on third parties to deliver raw materials, parts, components and services in adequate quality and quantity in a timely manner and at a reasonable price.

Our manufacturing operations depend on obtaining raw materials, parts and components, manufacturing equipment and other supplies including services from reliable suppliers in adequate quality and quantity in a timely manner. It may be difficult for us to substitute one supplier for another, increase the number of suppliers or change one component for another in a timely manner or at all due to the interruption of supply or increased industry demand. This may adversely affect our operations. The prices of raw materials, parts and components and manufacturing equipment may increase due to changes in supply and demand. In addition, currency fluctuations and a weakening of the U.S. dollar against foreign currencies may adversely affect our purchasing power for raw materials, parts and components and manufacturing equipment from foreign suppliers.

We depend on sole source suppliers or a limited number of suppliers for certain key raw materials and component parts used in manufacturing and developing our products. We generally purchase raw materials pursuant to purchase orders placed from time to time and if we deem necessary (and if possible), we will enter into long-term contracts or other guaranteed supply arrangements with our sole or limited source suppliers. Therefore, our operating margins may be impacted by price fluctuations in the commodities we use as raw materials in our batteries. As a result, our suppliers may not be able to meet our requirements relative to specifications and volumes for key raw materials, and we may not be able to locate alternative sources of supply at an acceptable cost. In the past, we have experienced delays in product development due to the delivery of raw materials from our suppliers that do not meet our specifications. In addition, if a sole source supplier ceased to continue to produce a component with little or no notice to us, our business could be harmed. Any future inability to obtain high quality raw materials or manufacturing equipment in sufficient quantities on competitive pricing terms and on a timely basis, due to global supply and demand or a dispute with a supplier, may delay battery production, impede our ability to fulfill existing or future purchase orders and harm our reputation and profitability.

Our inability to obtain federal and state government environmental permits and approvals for our planned U.S. manufacturing facilities could negatively impact our ability to obtain federal and state incentive funding and materially harm our business.

Pursuant to applicable environmental and safety laws and regulations, we are required to obtain and maintain certain governmental permits and approvals and to comply with applicable federal and state environmental laws and regulations. There is no guarantee that required determinations, permits and approvals will ultimately be obtained; the failure to obtain and/or maintain required federal and state environmental permits could have an adverse effect on our financial results and could also delay or prevent us from obtaining matching fund reimbursement from the $249.1 million grant we were awarded under the DOE Battery Initiative, as well as funding under the DOE ATVM loan program.

If obtained, permits and approvals may be subject to revocation, modification or denial under certain circumstances. Our operations or activities could result in administrative or private actions, revocation of required permits or licenses, or fines, penalties or damages, which could have an adverse effect on us. In addition, environmental laws will likely become more stringent over time, thereby requiring new capital expenditures and increases in operating costs.

Our working capital requirements involve estimates based on demand expectations and may decrease or increase beyond those currently anticipated, which could harm our operating results and financial condition.

In order to fulfill the product delivery requirements of our customers, we plan for working capital needs in advance of customer orders. As a result, we base our funding and inventory decisions on estimates of future demand. If demand for our products does not increase as quickly as we have estimated or drops off sharply, our inventory and expenses could rise, and our business and operating results could suffer. Alternatively, if we experience sales in excess of our estimates, our working capital needs may be higher than those currently anticipated. Our ability to meet this excess customer demand depends on our ability to arrange for additional financing for any ongoing working capital shortages, since it is likely that cash flow from sales will lag behind these investment requirements.

Credit market volatility and illiquidity may affect our ability to raise capital to finance our operations, plant expansion and growth.

The credit markets have experienced extreme volatility in recent years, and worldwide credit markets have remained unstable despite injections of capital by the federal government and foreign governments. Despite the capital injections and government actions, banks and other lenders, such as equipment leasing companies, have significantly increased credit requirements and reduced the amounts available to borrowers. Companies with low credit ratings may not have access to the debt markets until the liquidity improves, if at all. If current credit market conditions do not improve, we may not be able to access debt or leasing markets to finance our plant expansion plans.

We may be unable to successfully implement or manage our planned manufacturing expansion of capability or realize the expected benefits of an expansion.

We expect to aggressively expand our battery manufacturing capacity to meet expected demand for our products. Much of our planned domestic expansion, such as our current expansion in Livonia and Romulus, Michigan, depends upon our receipt of sufficient federal and state incentive funding and our ability to successfully ramp our manufacturing operations, particularly in the production of prismatic batteries. We may not receive the federal and state funding necessary for our planned expansion at all or on a timely basis. In addition, such funding could be subject to conditions that are commercially unacceptable to us or for which we are unable to comply. Even if we succeed in aggressively expanding our manufacturing capacity, we may not have enough demand for our products to justify the increased capacity.

Any such expansion will place a significant strain on our senior management team and our financial and other resources. Any expansion will expose us to greater overhead and support costs and other risks associated with the manufacture and commercialization of new products. Our ability to manage our growth effectively will require us to continue to improve our operations and our financial and management information systems and to train, motivate and manage our employees. Difficulties in effectively managing the budgeting, forecasting and other process control issues presented by such a rapid expansion could harm our business, prospects, results of operations and financial condition.

We may not be able to successfully recruit and retain skilled employees, particularly scientific, technical and management professionals.

We believe that our future success will depend in large part on our ability to attract and retain highly skilled technical, managerial and marketing personnel who are familiar with our key customers and experienced in the battery industry. Additionally, we plan to continue to expand our work force both domestically and internationally. Industry demand for such employees, especially employees with experience in battery chemistry and battery manufacturing processes, however, exceeds the number of personnel available, and the competition for attracting and retaining these employees is intense. This competition will intensify if the advanced battery market continues to grow, possibly requiring increases in compensation for current employees over time. We compete in the market for personnel against numerous companies, including larger, more established competitors who have significantly greater financial resources than we do and may be in a better financial position to offer higher compensation packages to attract and retain human capital. We cannot be certain that we will be successful in attracting and retaining the skilled personnel necessary to operate our business effectively in the future. Because of the highly technical nature of our batteries and battery systems, the loss of any significant number of our existing engineering and project management personnel could have a material adverse effect on our business and operating results.

Our future success depends on our ability to retain key personnel.

Our success will depend to a significant extent on the continued services of our senior management team, and in particular David Vieau, our chief executive officer, and Gilbert N. Riley, Jr., our chief technical officer. The loss or unavailability of either of these individuals could harm our ability to execute our business plan, maintain important business relationships and complete certain product development initiatives, which could harm our business. We do not have agreements requiring any of our senior management team to remain with our company. In addition, each of these individuals could terminate his or her relationship with us at any time, and we may be unable to enforce any applicable employment or non-compete agreements.

If we do not continue to form and maintain economic arrangements with original equipment manufacturers, or OEMs, to commercialize our products, our profitability could be impaired.

Our business strategy requires us to integrate the design of our products into products being developed by OEMs, and therefore to identify acceptable OEMs and enter into agreements with them. In addition, we will need to meet their requirements and specifications by developing and introducing new products and enhanced or modified versions of our existing products on a timely basis. OEMs often require unique configurations or custom designs for batteries or battery systems which must be developed and integrated into a product well before the product is launched. This development process requires not only substantial lead time between the commencement of design efforts for a customized battery system and the commencement of volume shipments of the battery systems to the customer, but also the cooperation and assistance of the OEMs in order to determine the requirements for each specific application. Technical problems may arise that affect the acceptance of our product by OEMs. If we are unable to design and develop products that meet OEMs' requirements, we may lose opportunities to obtain purchase orders, and our reputation may be damaged. In addition, we may not receive adequate assistance from OEMs to successfully commercialize our products, which could impair our profitability.

Declines in product prices may adversely affect our financial results.

Our business is subject to intense price competition worldwide, which makes it difficult for us to maintain product prices and achieve adequate profits. Such intense price competition may adversely affect our ability to achieve profitability, especially during periods of decreases in demand. In addition, because of their purchasing size, our larger automotive customers can influence market participants to compete on price terms. If we are not able to offset pricing reductions resulting from these pressures by improved operating efficiencies and reduced expenditures, those pricing reductions may have an adverse impact on our business.

Implementations of new software platforms or modifications to existing platforms may disrupt our business and operations and could harm our operating results.

The implementation of new software management platforms and the addition of these platforms at new locations, especially overseas, require significant management time, support and cost. As our business continues to develop, we expect to add and enhance existing management platforms in the areas of financial, inventory control, engineering, and customer support and warranty management. We cannot be sure that these platforms will be fully or effectively implemented on a timely basis, if at all. If we do not successfully implement or modify these platforms, our operations may be disrupted and our operating expenses could be harmed. In addition, the new systems may not operate as we expect them to, and we may be required to expend significant resources to correct problems or find alternative sources for performing these functions.

Our inability to effectively and quickly transfer, replicate and scale our new product manufacturing processes from low volume prototype production to high volume manufacturing facilities, could adversely affect our results of operations.

Under our manufacturing model, we develop and establish manufacturing processes and systems for the low volume prototype production of our new products. As demand increases for a product, we transfer these processes and systems to, and replicate and scale these processes and systems in our high volume manufacturing facilities. If we are unable to effectively and quickly transfer, replicate and scale these manufacturing processes and systems, such as replicating our prismatic pilot facility in Korea to our new facilities in Livonia and Romulus, Michigan, we may be unable to meet our customers' product quality and quantity requirements and lower our costs of goods sold and our results of operations could be adversely affected.

In addition, our costs of goods sold for some of our new products exceed the purchase price for that product paid to us by our customers. If we are unable to decrease unit production costs for these products by increasing volumes, improving the manufacturing process, reducing transportation and handling costs or obtaining lower cost raw materials or component parts, we will not realize a profit from these products and our business will be harmed.

Problems in our manufacturing and assembly processes could limit our ability to produce sufficient batteries to meet the demands of our customers.

Regardless of the process technology used, the manufacturing and assembly of safe, high-power batteries and battery systems is a highly complex process that requires extreme precision and quality control throughout a number of production stages. Any defects in battery packaging, impurities in the electrode materials used, contamination of the manufacturing environment, incorrect welding, excess moisture, equipment failure or other difficulties in the manufacturing process could cause batteries to be rejected, thereby reducing yields and affecting our ability to meet customer expectations.

As we have scaled up our production capacity, we have experienced production problems that limited our ability to produce a sufficient number of batteries to meet the demands of certain customers. For example, in 2010, we identified several significant technical issues in the manufacturing scale-up of our prismatic batteries. Although we identified and have taken corrective actions for these issues, the problems encountered resulted in a higher yield loss in ramp-up production, temporary halts in the production process and distraction of personnel. If these or other production problems recur and we are unable to resolve them in a timely fashion, our business could suffer and our reputation may be harmed.

Our failure to cost-effectively manufacture our batteries and battery systems in quantities which satisfy our customers' demand and product specifications and their expectations for product quality and reliable delivery could damage our customer relationships and result in significant lost business opportunities for us.

We manufacture a substantial percentage of our products rather than relying upon third-party outsourcing. To be successful, we must cost-effectively manufacture commercial quantities of our complex batteries and battery systems that meet our customer specifications for quality and timely delivery. To facilitate the commercialization of our products, we will need to further reduce our manufacturing costs, which we intend to do by working with manufacturing partners and by improving our manufacturing and development operations in our wholly-owned operations in China. We manufacture our batteries and assemble our products in China, Korea, Massachusetts and Michigan. We depend on the performance of our manufacturing partners, as well as our own manufacturing operations, to manufacture and deliver our products to our customers. If we or any of our manufacturing partners are unable to manufacture products in commercial quantities on a timely and cost-effective basis, we could lose our customers and be unable to attract future customers.

Table of Contents

In addition, we are shifting most of our battery assembly and all of our battery system manufacturing from contract manufacturing to in-house manufacturing, so our in-house experience with battery assembly and battery system manufacturing is limited.

We may be unable to complete or integrate acquisitions effectively, which may adversely affect our growth, profitability and results of operations.

We may pursue acquisitions as part of our business strategy. However, we cannot be certain that we will be able to identify attractive acquisition targets, obtain financing for acquisitions on satisfactory terms or successfully acquire identified targets. Additionally, we may not be successful in integrating acquired businesses into our existing operations and achieving projected synergies. Competition for acquisition opportunities in the various industries in which we operate may rise, thereby increasing our costs of making acquisitions or causing us to refrain from making further acquisitions. These and other acquisition-related factors could negatively and adversely impact our growth, profitability and results of operations.

We entered into a joint venture in China that, if not successful, could adversely impact our business, business prospects and operating results.

In December 2009, we formed a joint venture with SAIC Motor Co. Ltd., or SAIC, a leading automaker in China. We have a 49 percent minority interest in the joint venture, Shanghai Advanced Traction Battery Systems Co., Ltd., or ATBS, which is domiciled in Shanghai, China. Pursuant to the joint venture agreements, we are supplying ATBS with battery cells and, as requested by ATBS, we have granted necessary advanced technology licenses to ATBS for the development, manufacture and service of battery systems. In addition, we have made capital contributions to ATBS in an aggregate amount of $4.7 million.

The business of ATBS is subject to all the operational risks that normally arise for a technology company with global operations pertaining to research and development, manufacturing, sales, service, marketing and corporate functions. In addition, there could be disagreements between us and SAIC with respect to important strategic and operational decisions. Operating a business as a joint venture often requires additional organizational formalities as well as time-consuming procedures for sharing information and making decisions. We may be required to pay more attention to our relationship with SAIC, as the co-owner of ATBS, and if SAIC ceases to be the co-owner of ATBS, our relationship with ATBS may be adversely affected. Additionally, as we are sharing intellectual property with ATBS, we face the risks that we may not be able to maintain or enforce the rights to our intellectual property.

If the joint venture terminates, the joint venture could retain technical knowhow relating to battery systems transferred by us as part of the agreement. Additionally, we would have to find new partners or separately pursue market opportunities in China which could cause us to incur additional time and expense.

Laws regulating the manufacture or transportation of batteries may be enacted which could result in a delay in the production of our batteries or the imposition of additional costs that could harm our ability to be profitable.

Laws and regulations exist today, and additional laws and regulations may be enacted in the future, which impose environmental, health and safety controls on the storage, use and disposal of certain chemicals and metals used in the manufacture of lithium-ion batteries. Complying with any laws or regulations could require significant time and resources from our technical staff and possible redesign of one or more of our products, which may result in substantial expenditures and delays in the production of one or more of our products, all of which could harm our business and reduce our future profitability. The transportation of lithium and lithium-ion batteries and applicable customs duties are regulated both domestically and internationally. Compliance with these regulations, when applicable, increases the cost of producing and delivering our products.

We depend on contracts with the U.S. government and its agencies or on subcontracts with the U.S. government's prime contractors for revenue and research grants to fund or partially fund our research and development programs, and our failure to retain current or obtain additional contracts could preclude us from achieving our anticipated levels of revenue growth and profitability, increase our research, development and engineering expenses and delay or halt certain research and development programs.

Our ability to develop and market some of our products depends upon maintaining our U.S. government contract revenue and research grants obtained, which are recorded as incremental revenue and an offset to our research, development and engineering expenses, respectively. Many of our U.S. government contracts are funded incrementally, with funding decisions made on an annual basis. Approximately 12.3% of our total revenue and 7.5% of our research, development and engineering expenses during the year ended December 31, 2010 were derived from or funded by government contracts and subcontracts. Changes in government policies, priorities or programs that result in budget reductions could cause the government to cancel existing contracts or eliminate follow-on phases in the future which would severely inhibit our ability to successfully complete the development and commercialization of some of our products. In addition, there can be no assurance that, once a government contract is completed, it will lead to follow-on contracts for additional research and development, prototype build and test or production. Furthermore, there can be no assurance that our U.S. government contracts or subcontracts will not be terminated or suspended in the future. A reduction or cancellation of these contracts, or of our participation in these programs, would increase our research, development and engineering expenses, which could materially and adversely affect our results of operations and could delay or impair our ability to develop new technologies and products.

If we are unable to develop manufacturing facilities for our products in the United States, we may lose business opportunities and our customer relationships may suffer.

We believe that developing manufacturing facilities for our products in the United States is important, in order to address national security and economic imperatives, such as job creation, as well as to more efficiently address the needs of our U.S.-based customers. This expansion depends upon our receiving federal and state financial incentives, primarily in the form of direct grants and loans, to provide the necessary capital for facilities and equipment. If we are unable to obtain this government assistance on a timely basis and in the amounts requested, we will not be able to scale our capacity to meet current and future customer demand for our products.

Because of the funding we receive from U.S. government entities and our government business initiatives, we are subject to U.S. federal government audits and other regulation, and our failure to satisfy audit requirements or comply with applicable regulations could subject us to material adjustments or penalties that could negatively impact our business.

The accuracy and appropriateness of our direct and indirect costs and expenses under our contracts with the U.S. government are subject to extensive regulation and audit by appropriate agencies of the U.S. government. These agencies have the right to challenge our cost estimates or allocations with respect to any such contract. Additionally, substantial portions of the payments to us under U.S. government contracts are provisional payments that are subject to potential adjustment upon audit by such agencies. Adjustments that result from inquiries or audits of our contracts could have a material adverse impact on our financial condition or results of operations. Since our inception, we have not experienced any material adjustments as a result of any inquiries or audits, but there can be no assurance that our contracts will not be subject to material adjustments in the future.

Table of Contents

As we grow our government business, we may also need to comply with U.S. laws regulating the export of our products, particularly in our government business. We cannot be certain of our ability to obtain any licenses required to export our products or to receive authorization from the U.S. federal government for international sales or domestic sales to foreign persons. Moreover, the export regimes and the governing policies applicable to our business are subject to change. Our failure to comply with these and other applicable regulations, rules and approvals could result in the imposition of penalties, the loss of our government contracts or our suspension or debarment from contracting with the federal government generally, any of which would harm our business, financial condition and results of operations.

Our ability to sell our products to our direct, OEM and tier 1 supplier customers depends in part on the quality of our engineering and customization capabilities, and our failure to offer high quality engineering support and services could have a material adverse effect on our sales and operating results.

A high level of support is critical for the successful marketing and sale of our products. The sale of our batteries and battery systems is characterized by significant co-development and customization work in certain applications. This development process requires not only substantial lead time between the commencement of design efforts for a customized battery system and the commencement of volume shipments of the battery systems to the customer, but also the cooperation and assistance of the OEMs to determine the requirements for each specific application. Once our products are designed into an OEM or tier 1 supplier customer's products or systems, the OEM or tier 1 supplier customer depends on us to resolve issues relating to our products. If we do not effectively assist our OEM or tier 1 supplier customers in customizing, integrating and deploying our products in their own systems or products, or if we do not succeed in helping them quickly resolve post-deployment issues and provide effective ongoing technical support, our ability to sell our products would be adversely affected.

In addition, while we have supply and co-development agreements with customers located in different regions of the world, we do not have a globally distributed engineering support and services organization. Currently, any issue resolution related to our products, system deployment or integration is channeled back to our responsible business units in Massachusetts and in Michigan, from which engineers and support personnel are deployed. As we grow our business with our existing customers and beyond the markets into which we currently sell our battery technologies, we may need to increase the size of our engineering support teams and deploy them closer to our customers. Our inability to deliver a consistent level of engineering support and overall service as we expand our operations could have a material adverse effect on our business and operating results. Moreover, despite our internal quality testing, our products may contain manufacturing or design defects or exhibit performance problems at any stage of their lifecycle. These problems could result in expensive and time-consuming design modifications and impose additional needs for engineering support and maintenance services as well as significant warranty charges.

Our past and future operations may lead to substantial environmental liability.

The handling and use of some of the materials used in the development and manufacture of our products are subject to federal, state and local environmental laws, as well as environmental laws in other jurisdictions in which we operate. Under applicable environmental laws, we may be jointly and severally liable with prior property owners for the treatment, cleanup, remediation and/or removal of any hazardous substances discovered at any property we use. In addition, courts or government agencies may impose liability for, among other things, the improper release, discharge, storage, use, disposal or transportation of hazardous substances. If we incur any significant environmental liabilities, our ability to execute our business plan and our financial condition would be harmed. Our facilities or operations could be damaged or adversely affected as a result of disasters or unpredictable events, including widespread public health problems.

Table of Contents

Our headquarters, including administrative offices and research and development centers, are located in Massachusetts. We also operate manufacturing, logistics, sales and research and development facilities in Michigan, Missouri, China, Korea and Germany. If major disasters such as earthquakes, fires, floods, hurricanes, wars, terrorist attacks, computer viruses, pandemics or other events occur, or our information system or communications network breaks down or operates improperly, our facilities may be seriously damaged, or we may have to stop or delay production and shipment of our products. We may incur expenses relating to such damages some or all of which may not be covered by insurance. In addition, a renewed outbreak of a widespread public health problem in China or the United States could have a negative effect on our operations.

Risks Related to Intellectual Property

Third parties have asserted that they own or control patents that are infringed by our products.

We recently settled a patent litigation with Hydro-Qubec and the University of Texas, or UT, involving certain patents Hydro- Qubec has licensed from UT, related to electrode materials used in lithium-ion batteries. This litigation was initially commenced in 2006 and had been scheduled to go to trial in December 2011. For a more detailed discussion of our patent litigation, see Item 1 of Part II: "Legal Proceedings."

The mere existence, and the uncertainty with respect to the ultimate outcome, of any other patent litigation that we may become involved with, could cause our current and potential customers, development partners, the federal or state governments and licensees to stop, delay or avoid doing business with us or modify the extent to which they are willing to do business with us, and this loss or delay of business could harm our operating results and our ability to execute on our business plan.

Other parties may also bring intellectual property infringement claims against us which would be time-consuming and expensive to defend, and if any of our products or processes is found to be infringing, we may not be able to procure licenses to use patents necessary to our business at reasonable terms, if at all.

Our success depends in part on avoiding the infringement of other parties' patents and proprietary rights. We may inadvertently infringe existing third-party patents or third-party patents issued on existing patent applications. In the United States and most other countries, patent applications are published 18 months after filing. As a result, there may be third-party pending patent applications of which we are unaware, and which we may infringe once they issue. These third parties could bring claims against us that, even if resolved in our favor, could cause us to incur substantial expenses and, if resolved against us, could cause us to pay substantial damages. Under some circumstances in the United States, these damages could be triple the actual damages the patent holder incurs. If we have supplied infringing products to third parties for marketing or licensed third parties to manufacture, use or market infringing products, we may be obligated to indemnify these third parties for any damages they may be required to pay to the patent holder and for any losses the third parties may sustain themselves as the result of lost sales or damages paid to the patent holder. In addition, we may have, and may be required to, make representations as to our right to supply and/or license intellectual property and to our compliance with laws. Such representations are usually supported by indemnification provisions requiring us to defend our customers and otherwise make them whole if we license or supply products that infringe on third party technologies or violate government regulations. Further, if a patent infringement suit were brought against us, we and our customers, development partners and licensees could be forced to stop or delay research, development, manufacturing or sales of products based on our technologies in the country or countries covered by the patent we infringe, unless we can obtain a license from the patent holder. Such a license may not be available on acceptable terms, or at all, particularly if the third party is developing or marketing a product competitive with products based on our technologies. Even if we were able to obtain a license, the rights may be nonexclusive, which would give our competitors access to the same intellectual property.

Table of Contents

Any successful infringement action brought against us may also adversely affect marketing of products based on our technologies in other markets not covered by the infringement action. Furthermore, we may suffer adverse consequences from a successful infringement action against us even if the action is subsequently reversed on appeal, nullified through another action or resolved by settlement with the patent holder. As a result, any infringement action against us would likely harm our competitive position, be costly and require significant time and attention of our key management and technical personnel.

We may be involved in lawsuits to protect or enforce our patents, which could be expensive and time consuming.

Competitors or others may infringe our patents. To counter infringement or unauthorized use, we may be required to file patent infringement claims, which can be expensive and time-consuming. In addition, in an infringement proceeding, a court may decide that a patent of ours is not valid or is unenforceable, or may refuse to stop the other party from using the technology at issue on the grounds that our patents do not cover that technology. An adverse determination of any litigation or defense proceedings could put one or more of our patents at risk of being invalidated or interpreted narrowly and could put our patent applications at risk of not issuing.

Interference proceedings brought by the United States Patent and Trademark Office may be necessary to determine the priority of inventions with respect to our patent applications. Litigation or interference proceedings may fail and, even if successful, may result in substantial costs and be a distraction to our management. We may not be able to prevent misappropriation of our proprietary rights, particularly in countries where the laws may not protect such rights as fully as in the United States.

Furthermore, because of the substantial amount of discovery required in connection with intellectual property litigation, there is a risk that some of our confidential information could be compromised by disclosure. In addition, during the course of this litigation, there could be public announcements of the results of hearings, motions or other interim proceedings or developments. If securities analysts or investors perceive these results to be negative, it could have a substantial adverse effect on the price of our common stock.

We may not prevail in any litigation or interference proceeding in which we are involved. Even if we do prevail, these proceedings can be expensive and distract our management.

Our patent applications may not result in issued patents, which may have a material adverse effect on our ability to prevent others from commercially exploiting products similar to ours.

Patent applications in the United States are maintained in secrecy until the patents are published or are issued. Since publication of discoveries in the scientific or patent literature tends to lag behind actual discoveries by several months, we cannot be certain that we are the first creator of inventions covered by pending patent applications or the first to file patent applications on these inventions. We also cannot be certain that our pending patent applications will result in issued patents or that any of our issued patents will afford protection against a competitor. In addition, patent applications filed in foreign countries are subject to laws, rules and procedures that differ from those of the United States, and thus we cannot be certain that foreign patent applications related to issued U.S. patents will be issued. Furthermore, if these patent applications issue, some foreign countries provide significantly less effective patent enforcement than in the United States.

The status of patents involves complex legal and factual questions and the breadth of claims allowed is uncertain. Accordingly, we cannot be certain that the patent applications that we file will result in patents being issued, or that our patents and any patents that may be issued to us in the near future will afford protection against competitors with similar technology. In addition, patents issued to us may be infringed upon or designed around by others and others may obtain patents that we need to license or design around, either of which would increase costs and may adversely affect our operations.

Our patents and other protective measures may not adequately protect our proprietary intellectual property.

We regard our intellectual property, particularly our proprietary rights in our battery and battery system technology, as critical to our success. We have received a number of patents, and filed other patent applications, for various applications and aspects of our technology or processes and other intellectual property. In addition, we generally enter into confidentiality and invention agreements with our employees and consultants. Such patents and agreements and various other measures we take to protect our intellectual property from use by others may not be effective for various reasons, including the following:

- our pending patent applications may not be granted for various reasons, including the existence of conflicting patents or defects in our applications;

- the patents we have been granted may be challenged, invalidated or circumvented because of the pre-existence of similar patented or unpatented intellectual property rights or for other reasons;

- parties to the confidentiality and invention agreements may have such agreements declared unenforceable or, even if the agreements are enforceable, may breach such agreements;

- the costs associated with enforcing patents, confidentiality and invention agreements or other intellectual property rights may make aggressive enforcement prohibitive;

- even if we enforce our rights aggressively, injunctions, fines and other penalties may be insufficient to deter violations of our intellectual property rights; and

- other persons may independently develop proprietary information and techniques that are functionally equivalent or superior to our intellectual proprietary information and techniques but do not breach our patented or unpatented proprietary rights.

We may be unable to adequately prevent disclosure or misappropriation of trade secrets and other proprietary information.

We rely on trade secrets to protect our proprietary technologies, especially where we do not believe patent protection is appropriate or obtainable. However, trade secrets are difficult to protect. We rely in part on confidentiality and non-compete agreements with our employees, former employees, contractors, consultants, outside scientific collaborators and other advisors to protect our trade secrets and other proprietary information. These agreements may not effectively prevent disclosure of confidential information and may not provide an adequate remedy in the event of unauthorized disclosure of confidential information. Such unauthorized disclosure may also be difficult to prevent or enforce against current or former employees in locations outside of the United States (e.g., in China) where the legal systems and law enforcement are less developed, extradition treaties may not exist and business practices differ. In addition, others may independently discover our trade secrets or independently develop processes or products that are similar or identical to our trade secrets, and courts outside the United States may be less willing to protect trade secrets. Costly and time-consuming litigation could be necessary to enforce and determine the scope of our proprietary rights, and failure to obtain or maintain trade secret protection could adversely affect our competitive business position.

Table of Contents

Risks Associated With Doing Business Internationally and Specifically in China and Korea

Our substantial international operations subject us to a number of risks, including unfavorable political, regulatory, labor and tax conditions.

We have significant manufacturing facilities and operations in China and Korea that are subject to the legal, political, regulatory and social requirements and economic conditions in these jurisdictions. In addition, we expect to sell a significant portion of our products to customers located outside the United States. Risks inherent to international operations and sales, include, but are not limited to, the following:

- difficulty in enforcing agreements, judgments and arbitration awards in foreign legal systems;
- state ownership and/or support of competitive business entities;
- fluctuations in exchange rates may affect product demand and may adversely affect our profitability in U.S. dollars to the extent the cost of raw materials and labor is denominated in a foreign currency;
- impediments to the flow of foreign exchange capital payments and receipts due to exchange controls instituted by certain foreign governments and the fact that the local currencies of these countries are not freely convertible;
- inability to obtain, maintain or enforce intellectual property rights;
- changes in general economic and political conditions;
- changes in foreign government regulations and technical standards, including additional regulation of rechargeable batteries, power technology, or the transport of lithium or phosphate, which may reduce or eliminate our ability to sell or license in certain markets;
- requirements or preferences of foreign nations for domestic products could reduce demand for our products;
- trade barriers such as export requirements, tariffs, taxes and other restrictions and expenses, which could increase the prices of our products and make us less competitive; and
- longer payment cycles typically associated with international sales and potential difficulties in collecting accounts receivable, which may reduce the future profitability of foreign sales.

Our business in foreign jurisdictions requires us to respond to rapid changes in market conditions in these countries. Our overall success as a global business depends on our ability to succeed in different legal, regulatory, economic, social and political situations and conditions. We may not be able to develop and implement effective policies and strategies in each foreign jurisdiction where we do business. Also, each of the foregoing risks will likely take on increased significance as we implement plans to expand foreign manufacturing operations.

Since many of our products are manufactured in China, we own and lease manufacturing facilities in China and the Chinese market is of growing importance for our products, we face risks if China loses normal trade relations status with the United States or if US-China trade relations are otherwise adversely impacted.

We manufacture and export our products from China and own and lease manufacturing facilities in China. We also sell our products in China. Our products sold in the United States have normal trade relations status and are currently not subject to United States import duties. As a result of opposition to certain policies of the Chinese government and China's growing trade surpluses with the United States, there has been, and in the future may be, opposition to normal trade relations status with China. The United States Congress may also introduce China trade legislation targeting currency manipulation, which may adversely affect our business in China. The loss of normal trade relations

Table of Contents

status for China, changes in current tariff structures or adoption in the United States of other trade policies adverse to China, and any retaliatory measures that impact our products in the Chinese market, could have an adverse effect on our business.

A change in exchange rates mandated by legislation could negatively impact the cost of imported raw materials and products.

Furthermore, our business and operations may be adversely affected by deterioration of the diplomatic and political relationships between the United States and China. If the relationship between the United States and China were to materially deteriorate, it could negatively impact our ability to control our operations and relationships in China, enforce any agreements we have with Chinese partners or otherwise deal with any assets or investments we may have in China.

Our ongoing manufacturing operations in China are complex and having these remote operations may divert management's attention, lead to disruptions in operations, delay implementation of our business strategy and make it difficult to establish adequate management and financial controls in China. Our plans to grow our business to include sales to Chinese customers may necessitate additional management attention to establishing and maintaining one or more joint venture relationships with Chinese parties.

Currently, we have significant manufacturing operations in China, including a joint venture. We may not be able to find or retain suitable employees in China and we may have to train personnel to perform necessary functions for our manufacturing, senior management and development operations. This may divert management's attention, lead to disruptions in operations and delay implementation of our business strategy, all of which could negatively impact our profitability.

China has only recently begun to adopt management and financial reporting concepts and practices like those with which investors in the United States are familiar. We may have difficulty in hiring and retaining employees in China who have the experience necessary to implement the kind of management and financial controls that are expected of a United States public company. If we cannot establish and implement such controls, we may experience difficulty in collecting financial data and preparing financial statements, books of account and corporate records and instituting business practices that meet U.S. standards.

In order to grow our business and sales to Chinese customers we have entered into a Chinese-foreign joint venture with a Chinese partner. A Chinese-foreign joint venture can be a complex business arrangement requiring substantial management attention to the joint venture relationship. The joint venture will also require capital contributions and due to China's foreign exchange controls, uncertainty as to the ability to repatriate profits and principal out of China.

Because of the relative weakness of the Chinese legal system in general, and the intellectual property regime in particular, we may not be able to enforce intellectual property rights in China.

The legal regime protecting intellectual property rights in China is weak. Because the Chinese legal system in general, and the intellectual property regime in particular, are relatively weak, it is often difficult to create and enforce intellectual property rights in China. Accordingly, we may not be able to effectively protect our intellectual property rights in China against business entities, individuals and current and former employees.

Enforcing agreements and laws in China is difficult and may be impossible because China does not have a comprehensive system of laws.

We depend on our relationships with our Chinese manufacturing partners and suppliers. In China, enforcement of contractual agreements may be sporadic, and implementation and interpretation of laws may be inconsistent. The Chinese judiciary is relatively inexperienced in interpreting agreements and enforcing China's laws, leading to a higher than usual degree of uncertainty as to the outcome of any litigation. Even where adequate law exists in China, it may not be possible to obtain swift and equitable enforcement of such law, or to obtain enforcement of a judgment or an arbitration award by a court of another jurisdiction.

The government of China may change or even reverse its policies of promoting private industry and foreign investment, in which case our assets and operations may be at risk.

Our existing and planned operations in China are subject to risks related to the business, economic and political conditions in China, which include the possibility that the central government of China will change or even reverse its policies of promoting private industry and foreign investment in China. The government of China has exercised and continues to exercise substantial control over virtually every section of the Chinese economy through regulation and state ownership. Many of the current reforms which support private business in China are of recent origin or provisional in nature. Other political, economic and social factors, such as political changes, changes in the rates of economic growth, unemployment or inflation, or in the disparities of per capita wealth among citizens of China and between regions within China, could also lead to further readjustment of the government's reform measures. It is not possible to predict whether the Chinese government will continue to be as supportive of private business in China, nor is it possible to predict how any future reforms will affect our business. For example, if the government were to limit the number of foreign personnel who could work in the country, substantially increase taxes on foreign businesses, eliminate export processing zones, restrict the transportation of goods in and out of the country, adopt policies favoring competitors or impose other restrictions on our operations, the impact may be significant.

Significantly, a reversal of current liberalizations of foreign exchange controls by the Chinese government could be disruptive and costly to our cross-border operations and our business as a whole.

Business practices in China and Korea may entail greater risk and dependence upon the personal relationships of senior management than is common in North America, and therefore some of our agreements with other parties in China and Korea could be difficult or impossible to enforce.

The business cultures of China and Korea are, in some respects, different from the business cultures in Western countries and may present some difficulty for Western investors reviewing contractual relationships among companies in China and Korea and evaluating the merits of an investment. Personal and family relationships among business principals of companies and business entities in China and Korea are very significant in their business cultures. In some cases, because so much reliance is based upon personal relationships, written contracts among businesses in China and Korea may be less detailed and specific than is commonly accepted for similar written agreements in Western countries. In some cases, material terms of an understanding are not contained in the written agreement but exist as oral agreements only. In other cases, the terms of transactions which may involve material amounts of money are not documented at all. In addition, in contrast to Western business practices where a written agreement specifically defines the terms, rights and obligations of the parties in a legally-binding and enforceable manner, the parties to a written agreement in China or Korea may view that agreement more as a starting point for an ongoing business relationship which will evolve and require ongoing modification. As a result, written agreements in China or Korea may appear to the Western reader to look more like outline agreements that precede a formal written agreement. While these documents may appear incomplete or unenforceable to a Western reader, the parties to the agreement in China or Korea may feel that they have a more complete understanding than is apparent to someone who is only reading the written agreement without having attended the negotiations. As a result, contractual arrangements in China and Korea may be more difficult to review and understand.

Table of Contents

China has introduced sweeping reforms to its income tax, turnover tax and other tax laws and regulations. Some of the changes increase the taxes for foreign-invested and other businesses in China will incur on specific types of transactions as well as arising from operations generally in China. Our earnings may be affected by tax adjustments to reflect such changes in the law.

Pursuant to a comprehensive reform of China's tax system that took effect on January 1, 2008, income tax incentives granted to foreign-invested enterprises, and geographically-based incentives, have largely been eliminated and have been replaced with incentives designed to encourage enterprises, domestic and foreign-invested alike, in selected industries. For example, dividends paid by foreign-invested enterprises to foreign shareholders are no longer exempt from withholding tax. A 10% withholding tax applies to dividends, although the rate is reduced to 5% by certain tax treaties. The tax holidays and tax reduction periods and the reduced national income tax rate that foreign-invested enterprises engaged in production used to enjoy have also been removed. The tax incentives promised to our wholly foreign-owned subsidiaries located in export processing zones at the time of inception will be phased-out by the end of 2012. At that time, these subsidiaries and any new foreign-invested enterprises we might establish as part of our strategy to expand the market for our products will no longer have income tax advantages over Chinese domestic businesses.

China's turnover tax system consists of VAT, consumption tax and business tax. VAT is primarily imposed on import and sales of goods and certain services, such as repairing, processing and replacement. Export sales are exempt under VAT rules, and an exporter who incurs VAT on the purchase or manufacture of goods should be able to claim a refund from Chinese tax authorities. Depending on whether VAT export refund rates are raised or reduced for relevant goods, exporters might bear part of the VAT they incurred in conjunction with producing the exported goods. To mitigate the effects of the global economic downturn on China's export industry, the PRC Ministry of Finance and the State Administration of Taxation have raised VAT rebates on numerous exported labor-intensive and high-value-added products. However, the Chinese government may also lower rebate rates in future in response to different economic and policy objectives.

China has also introduced sweeping VAT policy reforms with effect from January 1, 2009, which facilitate China's shift from a production-based VAT scheme to a consumption-based system. Generally, the new system reduces the total output VAT of production enterprises as fixed-asset investment costs related to VAT-eligible output are no longer subject to VAT. However, our VAT costs will depend on our ability to pass on input VAT to our local suppliers and customers. As the relevant VAT law and implementing regulations are new, there may be a period of adjustment before any cost-savings are realized.

Business tax is usually a fee of 3-5 percent levied on services such as transport, construction, education, finance, and insurance transfer of intangible assets, and sales of fixed assets, none of which are generally eligible for VAT. Business tax regulations, which took effect January 1, 2009, may impose business on services exchanged among China- and foreign-based entities which previously were not subject to business tax, and the potential overall impact is to increase the tax burden of cross-border service transactions.

Frequent changes to China's tax laws can result in uncertainty and unpredictability in financial results of our operations in China. China's tax laws are supplemented with detailed implementation rules and circulars. However, the interpretation of the rules may vary among local tax authorities.

Table of Contents

Risks Related to Ownership of Our Common Stock

We are incurring increased costs and demands upon management as a result of complying with the laws and regulations affecting public companies, which could harm our operating results.

As a public company, we are incurring significant additional legal, accounting and other expenses that we did not incur as a private company, including costs associated with public company reporting requirements. We also have incurred and will incur costs associated with current corporate governance requirements, including requirements under Section 404 and other provisions of the Sarbanes-Oxley Act, as well as rules implemented by the Securities and Exchange Commission, or SEC, and the NASDAQ Global Select Market. The expenses incurred by public companies for reporting and corporate governance purposes have increased dramatically in recent years. These rules and regulations to increase our legal and financial compliance costs and to make some activities more time-consuming and costly. These new rules and regulations also make it more difficult and more expensive for us to obtain and maintain director and officer liability insurance, and we may be required to accept reduced policy limits and coverage or incur higher costs to obtain the same or similar coverage previously available. As a result, it may be more difficult for us to attract and retain qualified individuals to serve on our board of directors or as our executive officers.

An active trading market for our common stock may not be sustained, and you may not be able to resell your shares at or above the price at which you purchased them.

We have a limited history as a public company. An active trading market for our shares may not be sustained. In the absence of an active trading market for our common stock, investors may not be able to sell their common stock at or above the price they paid or at the time that they would like to sell.

Our stock price is volatile.

The market price of our common stock is highly volatile, and we expect it to continue to be volatile for the foreseeable future. For example, from September 24, 2009 through September 30, 2011, our common stock traded at a high price of $28.20 and a low price of $2.99. As a result of this volatility, you may not be able to sell your common stock at or above the price you paid. Some of the factors that may cause the market price of our common stock to fluctuate include:

- fluctuations in our quarterly financial results or the quarterly financial results of companies perceived to be similar to us;
- fluctuations in our recorded revenue, even during periods of significant sales order activity;
- changes in estimates of our financial results or recommendations by securities analysts;
- failure of any of our products to achieve or maintain market acceptance;
- the timing of the shipment and/or installation and validation of our products;
- product liability issues involving our products or our competitors' products;
- failure of our suppliers, many of which are sole source suppliers, to deliver products in a timely fashion or at all or any other delay in our supply chain;
- changes in market valuations of similar companies;

success of competitive products or technologies;

changes in our capital structure, such as future issuances of securities or the incurrence of debt;

Table of Contents

- announcements by us or our competitors of significant services, contracts, acquisitions or strategic alliances;
- developments or announcements related to our application for government stimulus funds;
- regulatory developments in the United States, foreign countries or both;
- litigation involving us, our general industry or both;
- additions or departures of key personnel;
- investors' general perception of us; and
- changes in general economic, industry and market conditions.

In addition, if the market for technology stocks or the stock market in general experiences a loss of investor confidence, the trading price of our common stock could decline for reasons unrelated to our business, financial condition or results of operations. If any of the foregoing occurs, it could cause our stock price to fall and may expose us to class action lawsuits that, even if unsuccessful, could be costly to defend and a distraction to management.

Sales of a significant number of shares of our common stock, or the perception that such sales could occur, could depress the market price of our common stock.

Sales of a substantial number of shares of our common stock in the public market could occur at any time. These sales, or the market perception that the holders of a large number of shares intend to sell shares, could reduce the market price of our common stock. As of March 31, 2011, 31,606,815 shares of our common stock were subject to a 90-day contractual lock-up with the underwriters. As of September 30, 2011, these shares are no longer under lock-up and these shares are able to be sold, subject to any applicable volume limitations under federal securities law.

In addition, the existence of the convertible notes may also encourage short selling by market participants because the conversion of the convertible notes could depress our common stock price. The price of our common stock could be affected by possible sales of our common stock by investors who view the convertible notes as a more attractive means of equity participation in us and by hedging or arbitrage trading activity that we expect to occur involving our common stock. This hedging or arbitrage could, in turn, affect the market price of our common stock and the convertible notes.

If securities or industry analysts do not publish or cease publishing research or reports about us, our business or our market, or if they change their recommendations regarding our stock adversely, our stock price and trading volume could decline.

The trading market for our common stock will be influenced by the research and reports that industry or securities analysts may publish about us, our business, our market or our competitors. If any of the analysts who may cover us change their recommendation regarding our stock adversely, or provide more favorable relative recommendations about our competitors, our stock price would likely decline. If any analyst who may cover us were to cease coverage of our company or fail to regularly publish reports on us, we could lose visibility in the financial markets, which in turn could cause our stock price or trading volume to decline.

Table of Contents

Our management has broad discretion over the use of our cash reserves and any government grants and loans we may receive, if any, and might not apply this cash in ways that increase the value of your investment.

Our management has broad discretion to use our cash reserves, including the proceeds received from our equity public offerings and our convertible debt offering, and you will be relying on the judgment of our management regarding the application of this cash. Our management might not apply our cash in ways that increase the value of your investment. We expect to use our cash reserves for capital expenditures, including capital expenditures related to the expansion of our manufacturing capacity in Michigan, working capital, and other general corporate purposes, which may in the future include investments in, or acquisitions of, complementary businesses, joint ventures, partnerships, services or technologies. Our management might not be able to yield a significant return, if any, on any investment of this cash. You will not have the opportunity to influence our decisions on how to use our cash reserves.

We do not expect to declare any dividends in the foreseeable future.

We do not anticipate declaring any cash dividends to holders of our common stock in the foreseeable future. Consequently, investors may need to rely on sales of their common stock after price appreciation, which may never occur, as the only way to realize any future gains on their investment. Investors seeking cash dividends should not purchase our common stock.

Anti-takeover provisions contained in our certificate of incorporation and bylaws, as well as provisions of Delaware law and provisions governing our convertible notes, could impair a takeover attempt.

Our certificate of incorporation, bylaws and Delaware law contain provisions that could have the effect of rendering more difficult or discouraging an acquisition deemed undesirable by our board of directors. Our corporate governance documents include provisions:

- authorizing blank check preferred stock, which could be issued with voting, liquidation, dividend and other rights superior to our common stock;
- limiting the liability of, and providing indemnification to, our directors and officers;
- limiting the ability of our stockholders to call and bring business before special meetings and to take action by written consent in lieu of a meeting;
- requiring advance notice of stockholder proposals for business to be conducted at meetings of our stockholders and for nominations of candidates for election to our board of directors;
- controlling the procedures for the conduct and scheduling of board of directors and stockholder meetings;
- providing the board of directors with the express power to postpone previously scheduled annual meetings and to cancel previously scheduled special meetings;
- establishing a classified board of directors so that not all members of our board are elected at one time;
- limiting the determination of the number of directors on our board of directors and the filling of vacancies or newly created seats on the board to our board of directors then in office; and
- providing that directors may be removed by stockholders only for cause.

These provisions, alone or together, could delay hostile takeovers and changes in control of our company or changes in our management.

79

Table of Contents

As a Delaware corporation, we are also subject to provisions of Delaware law, including Section 203 of the Delaware General Corporation Law, which prevents some stockholders holding more than 15% of our outstanding common stock from engaging in certain business combinations without approval of the holders of substantially all of our outstanding common stock. Any provision of our amended and restated certificate of incorporation or bylaws or Delaware law that has the effect of delaying or deterring a change in control could limit the opportunity for our stockholders to receive a premium for their shares of our common stock, and could also affect the price that some investors are willing to pay for our common stock.

In addition, if a "fundamental change" occurs pursuant to our convertible notes, holders of the convertible notes will have the right, at their option, to require us to repurchase all or a portion of their convertible notes. In the event of a "make whole adjustment event" under the convertible notes, we may be required to increase the conversion rate applicable to convertible notes surrendered for conversion in connection with such make whole adjustment event. In addition, the indenture governing the convertible notes prohibits us from engaging in certain mergers or acquisitions unless, among other things, the surviving entity assumes our obligations under the convertible notes. These provisions in the indenture governing the convertible notes may have the effect of delaying, deferring or preventing a change in control. These provisions may make it more difficult for other persons, without the approval of our board of directors or a committee thereof, to make a tender offer or otherwise acquire substantial amounts of our common stock or to launch other takeover attempts that a stockholder might consider to be in such stockholder's best interest. These provisions could also limit the price that some investors might be willing to pay in the future for shares of our common stock.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(a) Sales of Unregistered Securities

None

(b) Use of Proceeds from Public Offering of Common Stock

On September 29, 2009, we closed our IPO, in which 32,407,576 shares of common stock were sold at a price to the public of $13.50 per share. We sold 31,727,075 shares of our common stock in the offering and selling stockholders sold 680,501 of the shares of common stock in the offering. The aggregate offering price for all shares sold in the offering, including shares sold by us and the selling stockholders, was $437.5 million. The offer and sale of all of the shares in the IPO were registered under the Securities Act pursuant to a registration statement on Form S-1 (File No. 333-152871), which was declared effective by the SEC on September 23, 2009, and a registration statement on Form S-1 (File No. 333-162090) filed pursuant to Rule 424(b) of the Securities Act. The offering commenced as of September 23, 2009 and did not terminate before all of the securities registered in the registration statement were sold. Morgan Stanley & Co. Incorporated and Goldman, Sachs, & Co. acted as co-representatives of the underwriters. We raised approximately $391.8 million in net proceeds after deducting underwriting discounts and commissions of $30.0 million and other estimated offering costs of $6.7 million.

On April 6, 2011, we closed the public offering of 18,000,000 shares of our common stock which were sold at a price of $6.00 per share. On April 12, 2011, we closed the public offering of 2,184,067 additional shares of our common stock at a price of $6.00 per share in connection with the underwriters' exercise of their options to purchase additional shares. The aggregate net proceeds from the public offering, including shares sold under the underwriters' option, was $115.2 million. Deutsche Bank Securities Inc. and Goldman, Sachs & Co. acted as managers for the underwriters. The offer and sale of all shares in the public offering were registered under the Securities Act pursuant to a registration statement on Form S-3 (File No. 333-152871).

Table of Contents

No payments were made by us to directors, officers or persons owning ten percent or more of our common stock or to their associates, or to our affiliates, other than payments in the ordinary course of business to officers for salaries and to non-employee directors as compensation for board or board committee service, or as a result of sales of shares of common stock by selling stockholders in the offerings.

There has been no material change in the planned use of proceeds from our IPO and our public offering as described in our final prospectuses filed with the SEC pursuant to Rule 424(b). From the effective date of the registration statements through September 30, 2011, we used approximately $549.7 million of the net proceeds primarily to fund our operations and the expansion of our facilities to support the anticipated growth of our business. We have invested the remainder of the funds in a registered money market fund and U.S. treasury and government agency securities.

(c)

Restrictions on dividends

We have not paid any cash dividends since inceptions and do not anticipate paying cash dividends in the foreseeable future. Our term loan restricts our ability to pay cash dividends.

Item 6. Exhibits

The exhibits listed in the Exhibit Index immediately preceding the exhibits are filed (other than exhibits 32.1 and 32.2) as part of this Quarterly Report on Form 10-Q and such Exhibit Index is incorporated herein by reference.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

A123 SYSTEMS, INC.

Date: November 9, 2011	By:	/s/ DAVID P. VIEAU
		David P. Vieau *Chief Executive Officer* *(Principal Executive Officer)*
Date: November 9, 2011	By:	/s/ DAVID PRYSTASH
		David Prystash *Chief Financial Officer* *(Principal Financial Officer)*

Table of Contents

EXHIBIT INDEX

Listed and indexed below are all Exhibits filed as part of this report.

Exhibit No.	Description
10.34	Credit Agreement, dated September 30, 2011, among the Registrant, the Several Lenders from time to time parties thereto, and Silicon Valley Bank.
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 by Chief Executive Officer.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 by Chief Financial Officer.
32.1+	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, by Chief Executive Officer.
32.2+	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, by Chief Financial Officer.
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF*	XTRL Taxonomy Extension Definition

+ This certification shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to the liability of that Section, nor shall it be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934.

* Users of the XBRL data are advised pursuant to Rule 406T of Regulation S-T that this interactive data file is deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.